

CURRENT ECONOMIC PROBLEMS

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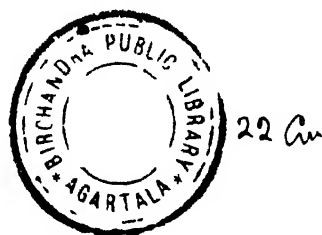
Inventory Investment: Concept and Measurement

Science, Culture and Man (Ed.)

CURRENT ECONOMIC PROBLEMS

With Special Reference to India

BEPIN BEHARI



330.954
B 419



VIKAS PUBLICATIONS

Bepin Behari (1926)

PRINTED IN INDIA

**AT THE CAXTON PRESS EXTENSION, CONNAUGHT CIRCUS,
NEW DELHI-1, AND PUBLISHED BY SHARDA CHAWLA, VIKAS
PUBLICATIONS, 5 DARYAGANJ, ANSARI ROAD, DELHI-6**

Dedicated
Most Reverentially to
MASTER M .:

PREFACE

THE economic crisis through which the country is passing involves an examination of many complex and delicate problems. Many writers have reviewed them and useful publications on the subject are available. The present study differs from others in its approach and the perspective it offers. It gives a new kind of analysis usually neglected in the literature dealing with Indian economic problems. There are many problems such as the question of unemployment, food scarcity, rising market prices and the need for a better standard of living which significantly influence the common man. Under democracy, he is intimately involved in policy decisions relating to these subjects. Such decisions, however, are not simple to arrive at. They require comprehensive study, serious deliberation, and well coordinated programmes for tackling them. This book attempts to equip the reader with the necessary wherewithals for analyzing the various economic problems confronting him with a view to enabling him to draw his own conclusions.

Decisions relating to planning strategy, market mechanism, private initiative, industrial licensing, and international economic transactions have profound impact on production and distribution of national wealth. But the economic decisions relating to these subjects are also very much affected by political considerations. It is true that social problems of any community cannot be tackled in isolation and before arriving at any final decision with regard to such subjects all aspects of human life should be considered. But, it assumes that the individuals who decide these matters should be aware of all the implications. In actual practice, however, this is not so. Therefore frustration prevails.

There are many socially desirable steps which have controversial long-term implications. As an illustration, the

question of granting subsidy may be considered. Subsidy to small industrialists or to certain kinds of agricultural farmers may be advisable at a particular stage of growth, but in the long-run, it might do more harm than good. Any financial assistance which unduly and for long buttresses weak economic enterprises might deprive some one else of his legitimate share in the national cake. It is a kind of redistribution of income whereby the fruits of those who earn are transferred to those who do not do so. In some cases such transfers might have valid justifications, whereas on other occasions, if such policies are indiscriminately and indefinitely carried out, they might damage the very springs of economic motivation and even destroy the long-term prospects of a better and prosperous existence. Emphasis on need-based wages without any increase in productivity, and socialization of industries and economic activities without introducing managerial efficiency might sometimes be harmful. There are some of the examples to indicate the complex nature of economic problems about which discussions should be objectively carried out and their various implications appropriately analyzed.

Economic decisions are not merely a bundle of personal prejudices and predilections. There is already an organized body of theoretical apparatus for analyzing such problems. One must familiarize oneself with this system of logical reasoning. Merely altruism would not be adequate for solving economic problems. It is necessary to have a fair degree of mastery, not only acquaintance, over these analytical tools. Many persons think that strong general common sense should be enough for passing judgments on vital economic matters with far reaching consequences. This dangerous tendency should be overcome. Theoretical framework for analyzing such economic problems must be made available to the general public so that they are able to participate in a meaningful way in the discussions relating to important problems connected with economic growth. This approach would be of great value even to advanced students endeavouring to grapple with these problems.

For such a task of creating enlightened public opinion on matters of grave concern, it would be the erudite academicians who would be admirably suited. They have better library facilities and greater opportunity for creative thinking. The professional economists saddled with enormous amount of routine jobs to perform have little energy and incentive for technical studies of the present type. But, these government economists engaged in day-to-day administrative decisions have certain special advantages of their own. Through a coordinated effort of these two groups of economists, it is possible to mobilize enough expertise for exploring and evolving suitable remedies for economic difficulties facing the country.

This book aims at assisting advanced students and mature readers in arriving at their own conclusions and as such it provides the basic data, analytical apparatus, and certain alternative conclusions necessary to stimulate the thinking process. But in this task, the author has been facing many difficulties. He has been aware of the fact that the economic tools are being refined everyday. Even the economic language has become highly esoteric. But, without a fair knowledge of this theoretical background, the reader might be swept by prejudices, personal bias, eloquence, and political overtones.

It is even difficult to apply sophisticated tools for analyzing the contemporary Indian economic problems. Apart from paucity of relevant statistical data, it is also apprehended that the theoretical discussions might even destroy the practical nature of the problems. On the other hand, there has been a danger that the abandonment of the theoretical model would make the policy decisions merely a matter of ad-hoc-ism. But in case the important economic decisions are not based on sound economic considerations and if they have no other justification than expediency, they cannot serve as foundation for long-term economic programming either. That is why economic administrators have to be very careful. They have to keep theoretical model in the background while considering the appropriateness of any economic decisions. Even when a

policy adopted by the government seems simple and merely an expression of ad-hoc-ism it would be naive to consider it so and to overlook the expertise behind such an apparent generality.

In the present study, salient features of eleven important economic problems have been discussed. The first chapter deals with prices. Undoubtedly, price mechanism is the solar orbit around which the national economy of every country revolves. The influence of market prices on everyday life is indeed extensive and profound. A rational policy with regard to them is likely to solve many complicated problems very smoothly. It could reduce administrative proliferation and red-tape, distribute national resources to the most appropriate lines of production and eliminate economic controls breeding spivory and corruption. Naturally, therefore, it is appropriate to discuss these problems at the very outset of the study.

Chapter II deals with deficit financing and Chapter III with devaluation. They are, in fact, two aspects of the first problem itself, namely, market prices. Deficit financing affects domestic value of the national currency, whereas devaluation changes its par value by the government decree and thereby alters its international purchasing power. It is interesting to examine the relationship between these three and to observe their impact on the life of the common man and on changes in the economy.

Exports and imports are discussed in fourth and fifth chapters. They are important during the course of economic development of every country. A former Governor of the Reserve Bank of India, P.C. Bhattacharya, has rightly stated that "ultimately, it is the exports which have to pay for our essential imports, the volume of which is bound to grow with the development of the economy and also to provide the wherewithal for the mounting debt-servicing obligations." But, the Indian exports, in spite of short-terms upward trends, have been stagnant considering the nature of the world trade. And, imports have also resisted all efforts to regulation and

control. It is necessary that appropriate action is taken with regard to these items in order to protect the country from another catastrophic foreign exchange debacle.

Chapter VI relating to agricultural development emphasizes the need for evolving a new strategy if the country has to attain viability with regard to food requirements and to meet the growing needs of her industrial inputs. The failure of rural industrialization, in spite of much efforts made in this direction, has been discussed in Chapter VII. This chapter is important in many ways. It shows the distinctive features of the rural economy and suggests the new line of approach which is essential for a successful plan of village transformation. Even if one is not in total agreement with the line of action suggested here, one may find this chapter interesting and throwing a new light on the problem of rural development.

Chapter VIII poses an important question which cannot be brushed aside lightly. It has been observed that ever since her independence, India has been passing every fifth year through acute economic strain; serious unemployment situation occurred during 1952-53, foreign exchange crisis in 1957-58, Chinese aggression in 1962-63, and industrial recession during 1967-68. While discussing the last problem, namely, the industrial recession, the author has suggested the possibility of another serious economic crisis in 1972 because he apprehends that all these difficulties in essence seem to arise from some common malady occurring in the country at a regular frequency of five years.

Chapter IX is concerned with unemployment. A summary of Keynesian theory of unemployment has been given here succinctly. The reader would find it useful. It would also indicate how the developmental strategy based on the Keynesian approach may not succeed in removing unemployment in an underdeveloped country. This has been amply demonstrated during the course of the implementation of the various five yearly plans in India. By the end of the Fourth Five Year Plan, the level of unemployment in the country may be unprecedented.

Without a discussion on the problem of foreign aid, no study on the economic development of a growing country would be complete. Economic growth is inextricably linked up with the supply of financial and technical assistance from abroad. But, during the recent years, there has been growing disillusionment about foreign aid among the major donor as well as among the recipient countries. Despite the billions of dollars worth of aid channellized from different countries, the progress has not been encouraging. The growing burden of debt-repayment and the implications of P.L. 480 commodity assistance are also important in the Indian context. They are discussed in Chapter X.

The final chapter on planning brings us to the consideration of certain aspects of planning philosophy and strategy. The question of planning is important because it is an effective instrument of social engineering, but is likely to encroach seriously on the growth of human personality. Planning is concerned with target fixation and mobilization of resources for achieving the goal. The rationale of target determination deserves careful consideration. The separation of decision-making and decision-implementing agencies is likely to contain dangerous possibilities. The need for concentration of decision-making function, risk bearing responsibility, and the right to enjoy the fruits of one's labour in order to bring about efficiency and harmony in the society might be important for planning which one may not afford to overlook. This chapter also deals with the latest trends in the Indian planning to show how for the basic issues have been tackled

These are some of the vital economic problems confronting the nation today. The author hopes that the reader would find these discussions rewarding. It should, however, be recognized that these are very abstruse problems requiring extensive studies. Nevertheless, it is hoped that this modest effort in this regard may be helpful to the general thinking process on these subjects.

Finally, I may mention here that the views expressed in

this book are entirely mine, and they do not necessarily reflect the views of the organizations I have been associated with. I would, however, like to express my gratitude to several colleagues and friends who helped me in many ways. Last, but by no means least, I am much indebted to my wife, Madhuri, for her valuable assistance and cooperation in the writing of the book. With care and attention, she helped me in the preparation of several chapters and in the compilation of many statements besides giving me psychological support on occasions when it was badly needed.

BEPIN BEHARI

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CHAPTER I

PRICE MECHANISM AND ITS OPERATION

FROM the earliest time until today, analytical economists have been deeply interested in the phenomenon of market prices. This apparently simple situation confronting every individual in his ordinary business of life has, however, eluded both the theoreticians and the administrators. The ancient Egyptians, Assyrians, Babylonians, and the Greeks developed elaborate monetary institutions to a high degree of perfection. Even the ancient Indian *Arthashastra* provided extensive injunctions regulating different prices. The rationale of market prices could not, however, be satisfactorily comprehended till recently. Although Aristotle distinguished between value-in-use and value-in-exchange, he rightly considered the latter as derived from the former, and he was even aware of the existence of "unjust" monopolists, yet he failed to discover a theory of prices.¹ It is true that most of the ancient administrators and philosophers were preoccupied with the ethics of pricing and were much concerned with avoiding its disturbing influences on the economic balance and the harmony of the society, but this by itself could not explain their inability to dig deep in the mechanism in order to analyze the rationale of the market behaviour. Their difficulties arose from the fact that they lacked adequately refined apparatus for analyzing the complicated phenomenon. It has taken mankind centuries of intellectual progress before it could develop suitable methodological tools for investigating the mechanism of price formation.

An understanding of the nature and significance of price mechanism and its operation might enable us to have a better

comprehension of the economic system in which we live; it might even bestow greater power for regulating the economic forces which influence our society. In fact, the modern exchange economy, in which the price mechanism is the central kingpin, has been so profoundly influenced by diverse human needs and heterogenous motivating urges that any analysis of this system, particularly beyond the Robinson Crusoe economy, would take the student to various spheres of human psychology.

Price mechanism is the crux of all economic problems. As a matter of fact, Marx assigned almost an esoteric significance to it. He indicated that the structure of economic system was vital for determining the class structure, and in this economic system prices played an important role. Price, according to Marx, is nothing but the monetary expression of value.² Equating "monetary expression of value" with the "Natural Price" of Adam Smith, and *Prix Necessaire* of the French Physiocrats and postulating every deviation of market prices from values or from natural price as intimately connected with the exploitation of labour which measured all values, Karl Marx raised his superstructure of the communistic philosophy on such an economic system which during the last one hundred and twenty-five years has vitally influenced the course of human history.

The significance of price mechanism is indeed very profound. It has recently been recognized that prices play a decisive role in allocating the shares of different factors of production, in determining social priorities, and in directing human motivating urges to desired social goals. Joseph A. Schumpeter has stated that the price formation as the specific economic characteristic of the economy, distinct from all other social, historical, and technical characteristics, is so extensive that within its framework all specifically economic events can be comprehended. Professor Schumpeter has further eulogized price mechanism by stating that "economics is merely a system of dependent prices; all special problems, whatever they

²Karl Marx, *Selected Works*, Foreign Language Publishing House, Moscow, 1947, p. 251.

may be called, are nothing but special cases of one and the same constantly recurring process, and all specially economic regularities are deduced from the laws of price formation."³ This clearly shows the importance of studying the problems relating to price formation very carefully in order to grasp the significance of various economic problems.

Conceptualization and Quantification

As indicated earlier, the analytical approach to the mechanism of prices is of recent origin. There is very little to report in this regard before the middle of the eighteenth century. The contributions of even the brightest lights such as Barbon, Petty, and Locke do not amount to much, and the vast majority of consultant administrators and pamphleteers of the seventeenth century were content with the kind of theory they found or could have found in Pufendorf, though that also did not amount to much. They attended primarily to practical problems of regulative policy and did not realize the need for rigorous "conceptualization" and proof. This task fell mainly on Adam Smith who made a systematic beginning in this regard. This Scottish economist, born of rich parentage and having been an economic administrator and a professor of moral philosophy, ultimately decided to publish *An Inquiry into the Nature and Causes of the Wealth of Nations* in 1776, which established him as "the founder of modern economics."⁴ Indeed, Adam Smith can be regarded as "the first to make a careful and scientific inquiry into the manner in which value measures human motive, on the one side measuring the desire of purchasers to obtain wealth, and on the other the efforts and sacrifices (or 'Real Cost of Production') undergone by its producers."⁵ Though *Wealth of Nations* "cannot rank with Newton's *Principia* or Darwin's *Origin* as an intellectual

³Joseph A. Schumpeter, *Ten Great Economists*, George Allen & Unwin, London, p. 84

⁴Alfred Marshall, *Principles of Economics*, Macmillan, London, p. 757.

⁵*Ibid.*, pp 758-9.

achievement, it is a great performance all the same and fully deserved its success.”⁶ The greatness of Adam Smith becomes clearer if we examine the treatment of value and prices in the hands of this great master.

During the period Adam Smith was engaged in preparing *Wealth of Nations*, the international commerce of Great Britain and of West European countries had been growing rapidly. The rising trend in prices, particularly under the impact of the influx of large volume of gold and silver bullions, the growing volume of commercial transactions due to the trading activities of several companies, and the beginning of the process of industrialization resulting from agricultural revolution brought about a radical transformation in economic thinking of the time. The Mercantilists, the Physiocrats, and many other non-conforming individual economists began examining the phenomenon scientifically, that is, by following the inductive method of enquiry. Adam Smith took advantage of this situation and skimmed the best brains of the time. He travelled extensively; he read voraciously, and frequented the society of Quesnay, Turgot, d’Alembert, the duc de la Rochefoucauld, and other luminaries of the time. He was profoundly influenced by his contacts with the members of the Physiocratic School. Thus, Adam Smith began his enquiry with adequately prepared background. This was further strengthened by the circumstances of his birth, training, experience, and intellectual “depth, solidity, and acuteness.” This enabled him to produce a treatise on economic science which rendered all works of his predecessors obsolete.

Adam Smith’s chief mission was “to combine and develop the speculations of his French and English contemporaries and predecessors as to value,”⁷ but his exposition at the very initial stages of his study “surges purposefully up to the phenomenon of price and down again into the component parts of commodity prices, which components are the cost and income cate-

⁶Joseph A. Schumpeter, *History of Economic Analysis*, p. 185.

⁷*Ibid.*, p. 307.

ries, wages, profit, and rent. That is, to repeat, a primitive way of describing the universal interdependence of the magnitudes that constitute the economic cosmos; but it is an effective way."⁸ Prices are important to quantify the volume of national wealth, but they are also significant in indicating value-in-exchange of the commodity.

Value of a thing may refer either to its utility or its purchasing power. The former may be called value-in-use and the latter value-in-exchange. Many commodities such as air and water have a low exchange value or not at all, whereas others much less useful in daily use such as diamond and gold have high exchange value. This is the paradox of value usually explained in terms of value-in-use and value-in-exchange. Adam Smith devoted himself to the study of the latter, with which we are confronted in our every-day transactions. He examined the problems relating to the quantification of exchange value and the forces regulating it. The real measure of the exchangeable value of all commodities, according to Adam Smith, is labour.⁹ He considered it so because "labour alone never varies in its own value." Equating value-in-exchange to price, Adam Smith observed that "price in money" fluctuated in response to purely monetary changes, and he replaced for purposes of inter-local and inter-temporal comparisons the monetary or "nominal price" of each commodity by a real price in the same sense in which we speak, for example, of real wages as distinguished from money wages, that is, by price in terms of all other commodities. And the real prices, he expressed in terms of labour, rather in terms of commodity labour, instead of commodity silver or the commodity gold as *numeraire*.¹⁰

Adam Smith has, during the course of his exposition, used various terms for different kinds of prices which are liable to at least three distinct interpretations. On this basis, he has been credited with three distinct theories of value, namely, (i)

⁸*Ibid.*, p. 308.

⁹*Encyclopaedia Britannica*, Adam Smith, Vol. 20, p. 825.

¹⁰Joseph A. Schumpeter, *History of Economic Analysis*, p. 188.

the labour quantity theory illustrated by beaver and deer example, (ii) the labour-disutility theory conveyed by his reference to toil and trouble, and (iii) the cost of production theory which actually is the central core of his analysis.¹¹ The labour-disutility theory may be considered as the primitive and crude form of the Opportunity Cost Theory which has been in vogue in recent times, but Adam Smith does not make use of it in this sense. He has stated that "the real price of every thing, what every thing really costs to the man who wants to acquire it, is the toil and trouble of acquiring it"¹². Adam Smith does not make much use of this concept, nonetheless, his labour quantity theory deserves better deal "If . . . it usually costs twice the labour to kill a beaver which it does to kill a deer, one beaver should naturally exchange for or be worth two deer"¹³. As an explanation of relative prices, this concept has much validity even presently

The cost theory, however, attempts to discover the ultimate constituents of the price of the thing "The produce of labour constitutes the natural recompense or wages of labour"¹⁴. Adam Smith has further stated that "the real value of all the different component parts of price, it must be observed, is measured by the quantity of labour which they can, each of them, purchase or command. Labour measures the value not only of price which resolves itself into labour, but of that which resolves itself into rent, and of that which resolves itself into profit"¹⁵. Adam Smith argues very clearly that wages profits, and rent which constitute the three ultimate sources of revenue are finally convertible into labour. He has indicated that "wages, profits, and rent are the three original sources of all revenues as well as of all exchangeable value. All other revenue is ultimately derived from some one or other of these."¹⁶ Adam Smith

¹¹*Ibid* , p 590

¹²Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (Ed Edwin Cannan), Modern Library, N Y., 1937, p 30

¹³*Ibid.*, p. 47.

¹⁴*Ibid* , p 64

¹⁵*Ibid* , p. 50

¹⁶*Ibid* , p. 52.

accepts wages or the recompense to labour as the cost of production: his explanation for the commodity prices in essence comes by way of the cost of production of the commodity.

Variations in Prices

Next important point to consider is the causes of variations in the commodity prices. These can be explained in many ways. Adam Smith has suggested three main causes for the same. Firstly, whenever some improvements are incorporated they would have different impact on agricultural prices and on those of manufactures. Every extension of cultivation is not necessarily conducive to greater yield relative to the amount of labour put into it. Generally, agricultural cultivation in such circumstances might yield less returns. On the other hand, the manufactures show favourable returns when improvements are incorporated, and thereby the prices of manufactured articles are likely to fall.

Secondly, Adam Smith referred to the fluctuations in wages and profits as having repercussions on prices. "High or low wages and profit are the causes of high or low price; high or low rent is the effect of it. It is because high or low wages and profit must be paid, in order to bring a particular commodity to market, that its price is high or low"¹⁷ This conclusion is mainly based on his assumption that labour is the ultimate determinant of prices, so whenever there is any change in the wages it should naturally be reflected in the cost-price relationship of the output.

Thirdly, Adam Smith also indicated that price changes could occur as a result of monetary factors. Debasement of the currency as a result of devaluation by the government and fraudulent clippings of coins by individuals does influence the price because these fraudulent practices do change the real value of the currency. Adam Smith stated that "the nominal sum which constitutes the market-price of every commodity is necessarily regulated, not so much by the quantity of silver,

¹⁷*Ibid.*, p. 147.

which according to the standard, ought to be contained in it, as by that which, it is found by experience, actually is contained in it. This nominal sum, therefore, is necessarily higher when the coin is much debased by clipping and wearing, than when near to its standard value."¹⁸ The torrent of American gold and silver bullions flowing into the European markets during the three hundred years before Adam Smith demonstrated to him the impact of monetary factors on the prevailing prices in any society.

Equilibrium Price

A significant contribution of Adam Smith has been his equilibrium theory of prices. This shows how market prices gravitate towards natural prices till they are normalized and coincide with them. The relationship between natural and market prices has been explained by Adam Smith as follows: "The natural price is, as it were, the central price, to which the prices of all commodities are continually gravitating. Different accidents may sometimes keep them suspended a good deal above it, and sometimes force them down even somewhat below it. But whatever may be the obstacles which hinder them from settling in this centre of repose and continuance, they are constantly tending towards it."¹⁹

While explaining the superiority of Adam Smith's equilibrium approach, Professor Schumpeter has stated that "the chief merit of Adam Smith's analysis of the price mechanism constitutes in this field."²⁰ As primitive but equally distinctly visible as is his concept of universal interdependence is his concept of equilibrium or "natural" price. This equilibrium price is the price by which it is possible to supply, in the long run, each commodity in a quantity that will equal "effective demand" at that price. This again is the price that will, in the long run, just cover costs. And these, in turn, are equal to the sum total of the wages, profits, and rents that have to be paid or imputed at their "ordinary or average rates." Adam Smith's market

¹⁸*Ibid.*, p. 194.

¹⁹*Ibid.*, p. 58.

²⁰Joseph A. Schumpeter, *Ten Great Economists*, p. 52.

price being essentially a short-run phenomenon, his "natural" price is a long-run one. Thus, when the different magnitudes of the economic cosmos are in balance in the long run, the "natural" prices prevail in the economy, whereas the market prices resulting from short-run disturbances might differ, nonetheless, they aim at meeting the natural prices all the time. This incidentally also shows the background of moral philosophy still persisting in economic analysis.

Adam Smith wielded considerable influence on subsequent economists. This, however, does not establish his logical superiority. One finds him often stating conclusions without logically proving the same. According to Joseph A. Schumpeter, Adam Smith has failed "to prove satisfactorily his proposition that the competitive price is 'the lowest which the sellers can commonly afford to take'; to the modern reader it is a source of wonder what kind of argument he took for proof. Still less did he attempt to prove that competition tends to minimize costs, though it is evident that he must have believed it."²¹ Adam Smith was never able to extricate the influence of moral philosophy on his economic studies. Probably, it is due to this background that he strongly felt the Invisible Hand guiding all factors of production to their most appropriate places yielding optimum result for the society. When each factor has been given freedom of initiative and bargaining, all components of the economic system would receive their maximum share in the national wealth.

Marshallian Synthesis

Adam Smith has been the founder of economic science, but modern economics rightly begins with Alfred Marshall. His *Principles of Economics* published in 1890 as a result of the "toil extending over more than twenty years" was a significant step, rather the foundation-stone for all subsequent thinking. The scope of this treatise has been vast and its impact profound. There is about it a peculiar quality which effectively

²¹Joseph A. Schumpeter, *History of Economic Analysis*, p. 309.

resists decay. During the period intervening between Adam Smith and Alfred Marshall, many eminent economists analyzed the economic phenomena and explored new avenues, but it has been to the credit of Alfred Marshall to assign appropriate place to all of them and to suggest rewarding directions for further investigations. Commenting upon the magnanimity and leadership of Alfred Marshall, Joseph A. Schumpeter has rightly indicated that "new problems, ideas, and methods that were enemies to the work of other men came to his own work as allies. Within the vast fortified camp that he built, there was room—in fact, there was accommodation prepared in advance—for them all."²² But, one must be aware that Alfred Marshall did not claim any authoritarian superiority for his analysis. What he attempted was to show that "the laws of economics are statements of tendencies expressed in indicative mood, and not ethical precepts in the imperative."²³ Again, while introducing his stationary equilibrium analysis, Alfred Marshall stated that his analysis was neither descriptive nor did it deal constructively with real problems.²⁴ His primary objective was to "set out the theoretical backbone of our knowledge of the causes which govern value."²⁵ It is possible to perceive his tribute to the Hegelian dialectics through his analysis of market prices: the "Real" gravitating towards the "Ideal." Ultimately, the normal price and market price might coincide but during the course of ordinary business of life, the reality of market price differed from the ideal of normal price.

Alfred Marshall in his *Principles of Economics* attempted to discover the manifold factors influencing the normal and market prices, which, in fact, are two aspects of the same phenomenon, the differences result from their expression in different time periods. At the very outset of his *magnum opus*, Alfred Marshall stated:

²²Joseph A. Schumpeter, *Ten Great Economists*, p. 93.

²³Alfred Marshall, *op. cit.*, pp. v-vi.

²⁴*Ibid.*, p. 324.

²⁵*Ibid.*

... as there is no sharp line of division between conduct which is normal, and that which has to be provisionally neglected as abnormal, so there is none between normal values and "current" or "market" or "occasional" values. The latter are those values in which the accidents of the moment exert a preponderating influence; while normal values are those which would be ultimately attained, if the economic conditions under view had time to work out undisturbed their full effect. But there is no impossible gulf between these two; they shade into one another by continuous gradations. . . .²⁵

From this, it may be seen that Alfred Marshall was conscious of the limitations and possibilities of his task. He meticulously collected his data and effectively meditated over the causes. When he set out on his mission of exploring the great vista of "conceptualization" of economic forces operating on the ordinary business of life, he was rewarded with an extensive panorama of economic cosmos which is both useful and fascinating. This enabled Alfred Marshall to build "not necessarily a body of concrete truth, but an engine for the discovery of concrete truth."²⁷ This great quality of Alfred Marshall in emphasizing the method rather than the conclusion endeared him to all subsequent generations of economists to whom he showed the way for economic investigations. Alfred Marshall showed to the economists the orchard of economic investigations, he did not offer them the fruits from his garden.

Marshallian Pair of Scissors

"The price of every thing rises and falls from time to time and place to place."²⁸ This raises an important problem of economic analysis. Any explanation of this phenomenon is, however, full of difficulties. We have already seen how Adam Smith had been trying to discover the essential ingredients in which terms

²⁵*Ibid.*, p. vii.

²⁷Joseph A. Schumpeter, *Ten Great Economists*, p. 101.

²⁸Alfred Marshall, *op. cit.*, p. 61.

the value of all articles could be expressed. Karl Marx had raised his superstructure of the exploitation theory of labour. The Austrians, besides many others, attempted to discover subjective measure of value. None of these could, however, present a comprehensive theory of value. William Stanley Jevons stated that "value depends entirely upon utility," but this did not end the controversy. Alfred Marshall emphasized the cost of production reflected in the supply schedule of the producer and the final utility expressed through the demand curve as the two component parts of the Law of Supply and Demand which finally led the individuals to every business transaction. Alfred Marshall stated:

We might dispute whether it is the upper or the under blade of a pair of scissors that cuts a piece of paper, as whether value is governed by utility or cost of production. It is true that when one blade is held still, and the cutting is effected by moving the other, we may say, with careless brevity, that the cutting is done by the second; but the statement is not strictly accurate, and is to be excused only so long as it claims to be a popular and not a strictly scientific account of what happens.²⁹

Joseph A. Schumpeter has criticized the Marshallian elaboration as meaningless and has affirmed that the cost of production principle is not different from the utility theory. He finds it

meaningless to accuse either Jevons or the Austrians of wishing to minimize the importance of the very theorem which they were first to deduce rationally and Friedrich von Wieser called the "law of costs." They stood in no need of being told about the two blades of Marshall's pair of scissors. What they aimed at showing was that *both* blades consist of the same material—that both demand and supply (no matter whether the case is one of exchang-

²⁹*Ibid.*, p. 348.

ing existing commodities or one of producing them) may be explained in terms of "utility."³⁰

But, Alfred Marshall did not consider both the blades to be of the same material. His effective contribution has indeed been in showing that both blades involved in this process behave independently. In a way, they may represent the two opposing sets of forces, those which impel men to economic efforts and sacrifices, and those which hold them back. These two sets of forces are important in determining market behaviour during any period.

Value is Relative

At a very early stage of his analysis, Alfred Marshall examined the different meanings of the two concepts, namely, value-in-exchange and value-in-use which had demanded attention even from Adam Smith and others. The former, that is value-in-exchange, has reference to "the power of purchasing other goods which the possession of that object conveys," and the latter, that is, value-in-use expressed the relationship between the object and the utility or the measure of satisfaction it provided to the consumer. Marshall did not very much like to use the concept in the latter sense, and with regard to value-in-exchange he stated that the "value, that is, the exchange value of one thing in terms of another at any place and time, is the amount of that second thing which can be got there and then in exchange for the first. Thus the term value is relative, and expresses the relation between two things at particular place and time."³¹

This relative value is usually expressed in terms of national currency. In this way, the purchasing power of money also enters the arena of market behaviour. But, the measurement of the changes in value of money is a difficult proposition. "If the purchasing power of money rises with regard to some things, and at the same time falls equally with regard to equally

³⁰Joseph A. Schumpeter, *History of Economic Analysis*, p. 922.

³¹Alfred Marshall, *op. cit.*, p. 61.

important things its general purchasing power (or the power of purchasing things in general) has remained stationary."³² But such a balance is not always maintained. Every commodity behaves independently. Therefore, "stationariness" in the general purchasing power of money cannot be assumed. Moreover, money is not only a measure of value—*numeraire*—it is also a positive factor in determining market conditions. It is unrealistic to postulate neutral money, particularly in the present context. By incorporating the influence of money on market conditions, the subject-matter would for the time-being become very much complicated. Therefore, in his *Principles of Economics*, Alfred Marshall has overlooked the influence of money in prices. This assumption has reduced the realistic nature of his analysis, but it has certainly very much simplified the analysis.

Stationary or Partial Equilibrium

The central theme of Marshallian analysis has been the stationary or partial equilibrium. He has examined the general relations of demand and supply; especially those which are connected with that adjustment of price, by which they are maintained in "equilibrium."³³ This analysis has two sides, namely, analysis of supply prices and analysis of demand conditions. From the standpoint of demand analysis, every article is required for satisfying a consumer demand either directly or indirectly. When a trader or a manufacturer buys a thing for employing it in producing other things which could satisfy the consumer's want directly, then, in that case the article bought by the trader or the manufacturer is said to satisfy the consumer indirectly. But, in such transactions also, the motive for transaction comes from the urge to satisfy consumers' demand. The ultimate regulator of all demand is, therefore, consumers' demand.³⁴

The multifarious and complex nature of human wants can never be measured by any objective yardstick but the economists attempt to measure the intensity of desire or want by the willing-

³²*Ibid.*, p. 62.

³³*Ibid.*, p. 323.

³⁴*Ibid.*, p. 92.

ness of the individual to pay for its fulfilment or satisfaction. This may be an unsatisfactory approach, but that is the fundamental postulate for all economic analysis. Granting the validity of this approach, no one would object to the fact that every individual, at the earlier stages of the act of satisfying his wants, would be willing to pay higher prices (or undergo greater sacrifice) than at a later stage. "In other words, the additional benefit, which a person derives from a given increase of his stock of a thing, diminishes with every increase on the stock that he already has."³⁵ As a result of this tendency, the amount of the commodity that the individual would like to possess would depend upon the satisfaction derived from that unit and the sacrifice necessary for the same; when the two are in balance there the transaction will be made. "That part of the thing which he is only just induced to purchase may be called his *marginal purchase* because he is on the margin of doubt whether it is worth his while to incur the outlay required to obtain it."³⁶ Aggregation of all such demands of different individuals would give the total demand for the commodity. The responsiveness of the demand to different levels of price is known as the elasticity of demand and this "elasticity (or responsiveness) of demand in a market is greater or small according to the amount demanded increases much or little for a given fall in price, and diminishes much or little for a given rise in price."³⁷

Demand becomes efficient only when the price which the individual is willing to offer reaches that level at which others are willing to sell.³⁸ Willingness of the seller to offer different amounts of the commodity at different prices represents his supply schedule. It is determined by his marginal cost of production of the article. An individual inquiring into the different types of expenditure which would determine the normal supply of a certain quantity of any commodity would have to reckon such factors as (i) prices of the raw materials required to produce the commodity, (ii) wear-and-tear and

³⁵*Ibid.*, p. 93.

³⁶*Ibid.*

³⁷*Ibid.*, p. 102.

³⁸*Ibid.*, p. 95.

depreciation of the building, machinery, and other fixed capital, (iii) interest and insurance charges on capital employed, (iv) wages of those who work in the factories, and (v) the gross earnings of management (including insurance against loss), of those who undertake the risks, who engineer and superintend the working. Such estimates will have to be made with reference to the amounts of each of them that would be wanted.³⁹

Besides, Prime Costs and Supplementary Costs also figure in these reckonings. Prime or Special cost refers to the (money) cost of raw materials used in making the commodity, wages of that part of the labour spent on it which is paid by the hour or the piece, and the extra wear-and-tear of plant.⁴⁰ Supplementary cost meant the "standing charges on account of the durable plant in which much of the capital of the business has been invested, and also the salaries of the upper employees: for the charges to which the business is put on account of their salaries cannot generally be adapted quickly to changes in the amount of work there is for them to do."⁴¹ Such estimates are often difficult, particularly so in the case of joint supply: beef and hide or mutton and wool are illustrations of joint supply and variations in the proportion of their joint supply are not always possible. In such cases, estimation of the cost of production for different units of the outputs taken separately is difficult. However, these difficulties will have to be surmounted in order to work out the supply schedule.

Alfred Marshall has stated that the volume of production adjusts itself to the conditions of market, and normal price is determined at the position of stable equilibrium of normal demand and normal supply.⁴² When the demand and the supply prices are equal, the amount produced has no tendency either to increase or to diminish; it is in equilibrium. When demand and supply are in equilibrium, the amount of the commodity which is being produced in the unit time may be called the *equilibrium*

³⁹*Ibid.*, p. 347.

⁴⁰*Ibid.*, p. 360.

⁴¹*Ibid.*

⁴²*Ibid.*, p. 338.

amount, and the price at which it is being sold may be called the *equilibrium price*.⁴³ This equilibrium price is attained when the marginal demand price and the marginal supply price are in balance. Prices thus reached would be the normal price.

Element of Time

Element of time is significant in determining the market equilibrium. Alfred Marshall himself conceded that "the difficulties of the problem depended chiefly on variations in the area of space, and the period of time over which the market in question extends; the influence of time being more fundamental than that of space."⁴⁴ Many factors affect the extent of the market. They relate to the nature of demand for the commodity, means of transportation, durability of the commodity, and the relationship between its value and bulk. Again, markets vary according to the period of time which is allowed to the forces of demand and supply to bring themselves into equilibrium with one another, as well as with regard to the area over which they extend.⁴⁵ Detailed examination of such market forces would be necessary for a clearer understanding of the equilibrium position.

The significance of time-element in the present context is much more important than ordinarily granted to it. Alfred Marshall has himself stated that the element of time "requires more careful attention just now than does that of space."⁴⁶ But, periodization is always a difficult problem. Any endeavour to demarcate time within distinct limits is artificial. Such divisions are attempted only to aid clarity in thinking. Determination of price, in every period, according to Alfred Marshall, would result from the interaction of supply and demand conditions. Forces operating behind supply and demand, however, would distinctly depend upon the time horizon taken into account.

At any point of time, supply would mean the stock of the commodity in question which is on hand, or at all events "in sight." When the period under consideration is a few months or a

⁴³*Ibid.*, p. 346.

⁴⁴*Ibid.*, p. 496.

⁴⁵*Ibid.*, p. 330.

⁴⁶*Ibid.*

year, supply would mean broadly what can be produced for the price in question with the existing stock of plant, personal, and impersonal, in the given time. When a longer period extending over several years is taken into account, supply would refer to what can be produced by plant which itself can be remuneratively produced and applied within the given time, while there are very gradual or *secular* movements of normal price caused by the gradual growth of knowledge, population, and of capital, and the changing conditions of demand and supply from one generation to another.⁴⁷

Similarly, demand would refer to different sets of conditions for different time-horizons. Taste, consumption pattern, availability of substitutable commodities, growth in population, changes in disposable income, and several such other factors would influence demand: their impact would differ according to the period of time taken into account. Alfred Marshall had already seen the possibility of both blades of the pair of scissors not functioning actively, and in the same manner for all time-horizons. The general principle of equilibrium may have to be qualified in certain ways. For this reason, Alfred Marshall stated: "We may conclude that, as a general rule, the shorter the period which we are considering the greater must be the share of our attention which is given to the influence of demand on value; and the longer the period, the more important will be the influence of cost of production on value."⁴⁸

Divergence between market and normal prices, according to Alfred Marshall, could be minimized only in a long period; during the short period, both may vary depending upon the vagaries of circumstances. Marshall has stated:

The actual value at any time, the market value, as it is often called, is often more influenced by passing events and by causes whose action is fitful and short lived, than by those which work persistently. But in long periods these fitful and irregular causes in larger measure efface one

⁴⁷*Ibid.*, pp. 378-9.

⁴⁸*Ibid.*, p. 345.

another's influence; so that in the long run persistent causes dominate value completely. Even the most persistent causes are however liable to change. For the whole structure of production is modified, and the relative costs of production of different things are permanently altered, from one generation to another.⁴⁹

Marshallian equilibrium analysis as a theoretically consistent apparatus for analyzing market mechanism may be very useful, but the element of time introducing divergence between normal and market prices makes such an apparatus of doubtful validity for practical purposes.

Marshallian Contribution Re-stated

Summing up the Marshallian contribution to the analysis of market mechanism, it may be stated that the most important consideration has been given to the stationary equilibrium analysis. According to this approach, when demand and supply are in equilibrium, the amount of commodity which is being produced in a unit of time may be called the *equilibrium amount* and the price at which it is being sold may be called the *equilibrium price*.⁵⁰ Equilibrium price is influenced by the period of time that is allowed for supply and demand conditions to adjust. As a general rule, the influence of demand on value is greater during the shorter period under consideration, whereas the influence of cost of production is greater when the period under consideration is longer.⁵¹ The influence of the cost of production on values does not show itself clearly except in relatively long periods, and it is to be estimated with regard to a whole process of production rather than to a particular parcel of goods.⁵² The cost of production as a determinant of the price is considered at the margin of operation; it refers to the cost of production of that part of it which is raised on the margin, that is, under such unfavourable condition as to yield no rent.⁵³

This apparatus of analysis is fruitful only in competitive econo-

⁴⁹*Ibid.*, pp. 349-50.

⁵⁰*Ibid.*, p. 345.

⁵¹*Ibid.*, p. 349.

⁵²*Ibid.*, pp. 361-2.

⁵³*Ibid.*, p. 499.

my with diminishing returns under operation. When the production process is experiencing increasing returns, its true character may not be perceived in short period and the "statical theory of equilibrium is not wholly applicable in that case." Normal price resulting from the equilibrium of normal demand and supply, however, is neither the average price nor the market price; it is only by accident that an average price will be a normal price. Despite the lucid exposition of his theory of prices, Alfred Marshall has himself cautioned that any theory based on a series of assumptions in order to simplify matter could not be helpful:

In this world therefore every plain and simple doctrine as to the relations between cost of production, demand and value is necessarily false; and the greater the appearance of lucidity which is given to it by skilful exposition, the more mischievous it is. A man is likely to be a better economist if he trusts to his common sense, and practical instincts, than if he professes to study the theory of value and is resolved to find it easy.⁵⁴

Therefore, we shall have to be very careful in approaching the problem of pricing.

The Impact of Money

In order to analyze the problem of prices from a practical standpoint, one cannot be overlooking monetary factors. Specially in relation to market prices, money plays a vital role. One must, therefore, analyze the impact of money on prices and production. Money, in everyday life, plays an important role. Over business transactions, it functions like a veil, whereas for industries it oils their wheels. As such, it does not remain merely a medium of exchange and a standard of value. Money plays a positive role in economic cosmos.

Importance of money in determining general level of prices is widely acknowledged. The quantity theory of money with its

⁵⁴*Ibid.*, p. 368.



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various refinements is extensively discussed in this context, but we do not wish to elaborate that theory here. Our main concern is to discuss fluctuations in *relative* prices and variations in prices, inter-temporal and inter-spatial, with a view to examining its impact on the level of production.⁵⁵

The quantity theory of money, though a valuable contribution for understanding the dynamic economic relationships, does not throw much light on the problem at hand. Professor Friedrich A. Hayek has indeed emphasized the need for a monetary theory which could explain the impact of money on relative prices. In fact, whenever the amount of money varies in a society, the change does not take place simultaneously so that the amount at the disposal of everyone is changed proportionately. Variation in the quantity of money changes the relative income distribution in the community. Disposable income of the individual taken together with his consumption pattern determines the quantity of different articles he would be demanding. Money also alters the marginal utility of different commodities he would be consuming. Thus, a different order of priorities comes into operation. Entire demand schedule of the community, depending upon the distribution of income and the proportion of increased quantity of money flowing to different groups of population, is changed. It would establish a new equilibrium between production and prices.

Money also influences the production decisions of various entrepreneurs. It affects the inventory accumulation of traders and businessmen. But, everyone of this group is not affected identically. Investment planning by different industrialists is very much influenced by the prevailing rates of interest. But, the elasticity of production schedules differs for different industries. Moreover, some people would have acquired a larger share in the increased quantity of money and others would have received less. When selective credit control and credit guarantee schemes for privileged groups of industrialists are in operation, they would take advantage of the increasing amounts of

⁵⁵F. A. Hayek, *Prices and Production*, George Routledge, London, 1941.

money at their disposal. Availability of money supply at different rates of interest to different groups of industrialists would affect the cost of production of various commodities. Such variations would also alter normal supply and normal demand prices, thus leading to a new equilibrium. These changes would not only lead to a new level of general price but they would also influence the relative prices.

Practical problems relating to prices in any community do not require that we only studied the monetary aspect of the question. Many other problems also become necessary whose study would be helpful. For taking a comprehensive view and to be effective in price control administration, many other matters affecting prices have to be studied. Even the simple supply and demand analysis described earlier assumes many relationships as given which do not always pertain to actual life. Perfect competition, which is based on the assumption that every entrepreneur is free to enter into production activities and to quit them whenever he finds it necessary because of his incurring persistent loss, does not hold always good. There are many restrictions, almost in every type of economy, which limit the freedom of the entrepreneurs.

Controls and Restrictions

In underdeveloped countries, there are often too many controls and restrictions. Therefore to expect competition in such economies is unrealistic. The price mechanism, in fact, operates in varying degrees of imperfections. But, perfect competition and perfect monopoly are two extremes of the scale. Moreover, there are limitations even on the consumers side. Here we are not thinking of ignorance about the availability of different products and of the price differentials prevailing for similar articles in different markets but of those conditions which arise due to pooling together of individual requirements as in the case of consumers cooperative societies or due to the emergence of public sector activities when large-scale purchases are made by public authorities on the basis of tenders submitted to it. Under such conditions, the producers do not face perfect competition.

Transport facilities which are expected to convey immediately cheaper articles to markets where higher prices prevail are not always available. During recent years, many governments have assumed the responsibility for providing essential commodities at reasonable prices to the masses. But, this can be possible only when the prices are controlled. Such controls have also to be accompanied by government procurement measures. When these conditions prevail, it is natural to expect distortions in natural price mechanism. The levels of outputs and the levels of prices for different articles are different in controlled markets from what they would have been otherwise.

Black marketing is already an established fact in economic life. An analysis of these factors would take us to the very depth of theoretical economics. Here we do not intend to go to that extent. In order to indicate some of the significant situations under these conditions, a set of diagrams is, however, given here which might enable us to visualize some of the interesting features of the price-output equilibrium attained under different conditions.

The first three figures in the diagram (p. 24) represent the Marshallian equilibrium positions. The equilibrium positions in these diagrams refer to constant, diminishing, and increasing returns. In Fig. 3, increasing return obtains after the level of production has reached Oh . In each case SS' is the supply curve, DD' is the old position of the demand curve, and dd' its position after the change in normal demand. In each case A and a are respectively the old and new positions in equilibrium; AH and ah are the old and new normal or equilibrium prices; and OH and oh , the old and new equilibrium amounts.

Fig. 4 shows equilibrium of the firm as indicated by Professor J. R. Hicks. Supposing that an amount ON of the factor is being employed, and the amount of product secured is PN , and MK represents the quantity of product whose market value equals the value of ON , then OK is the surplus product accruing to the enterprise. The conditions of the equilibrium

EQUILIBRIUM POSITIONS OF PRICE AND OUTPUT UNDER DIFFERENT CONDITIONS Marshallian Equilibrium Positions

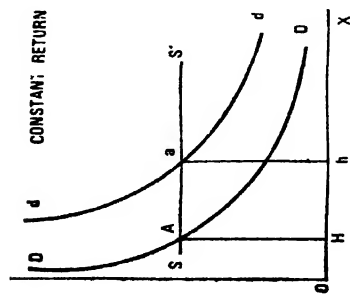


FIG. 1

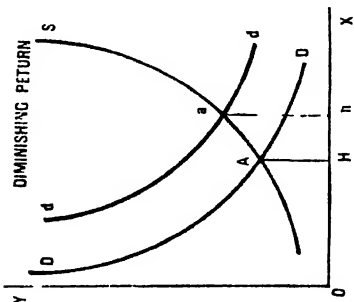


FIG. 2

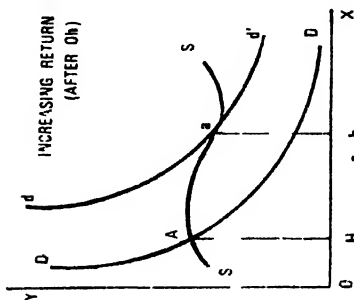


FIG. 3

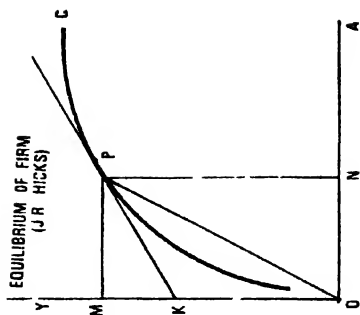


FIG. 4

EQUILIBRIUM POSITIONS OF PRICE AND OUTPUT UNDER DIFFERENT CONDITIONS

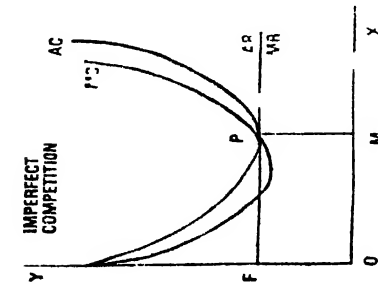


FIG. 5

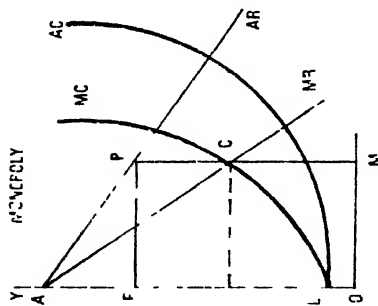


FIG. 6

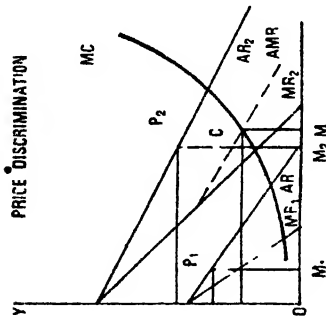


FIG. 7

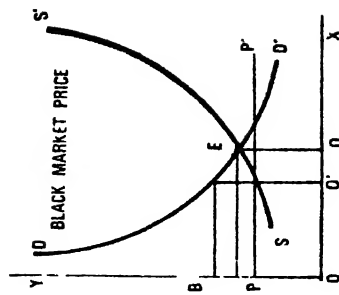


FIG. 8

AR : Average Revenue
MR : Marginal Revenue
AC : Average Cost
MC : Marginal Cost

DD' : Demand Curve
SS' : Supply Curve
OX : Levels of Output
OY : Levels of Price

AMR : Aggregate Marginal Revenue
PP' : Controlled Price
PB : Range of Black Market Price

NOTE : In Fig. 7, M_2P_2 would intersect MR_2 at a height equal to CM .

are that OK should be maximum, and should be positive, which are attained when KP is tangential. J. R. Hicks elaborates the condition by indicating that the slope of the production curve at the point of equilibrium must equal the ratio of the prices of the factors to the price of the product. Secondly, the production curve must be convex upwards at the point of tangency, and, thirdly, the slope of OP must be greater than that of PK . These conditions may be classified under two sets of alternative forms:

Price of factor	Price of product
= Value of marginal product	= Marginal cost
Marginal product diminishing	Marginal cost increasing
Average product diminishing	Average cost increasing

Fig 5, 6, and 7 show equilibrium positions under perfect competition, monopoly, and price discrimination in two isolated markets. Full equilibrium requires a double condition, that marginal revenue is equal to marginal cost, and that average revenue (or price) is equal to average cost. The double condition of full equilibrium can only be fulfilled when the individual demand curve of the firm is a tangent to its average cost curve. When competition is perfect, marginal revenue is equal to price (or average revenue). Marginal/cost also, therefore, must be equal to average revenue. But, for full equilibrium, price (or average revenue) must be equal to average cost. "Full equilibrium can therefore only be attained, under perfect competition," according to Mrs Joan Robinson, "when marginal cost is equal to average cost. Marginal and average cost are equal at the minimum point on the average cost curve." Equilibrium under monopoly, according to Mrs Robinson, is determined where marginal cost equals marginal revenue (Fig. 6). Monopoly price is equal to marginal cost multiplied by $e/e - 1$, if e is the elasticity of demand. Price under monopoly would, therefore, be equal to the demand price (AR) for the amount of output (OM) sold there.

The monopoly output under price discrimination (Fig. 7) is

determined by the intersection of the monopolist's marginal cost curve (MC) with the aggregate marginal revenue curve (AMR). The total output (OM) is made of the amounts (OM_1 and OM_2) sold in the two markets, 'in each of which the marginal revenue curves (MR_1 and MR_2) is equal to the marginal cost of the whole output (MC). The price in each market (P_1 and P_2) will be the demand price (AR_1 and AR_2) for the amount of output (OM_1 and OM_2) sold there.

During the period of price control (Fig. 8), if the administratively decided price (OP) is lower than the normal price (QE), the situation would not be stable; black-market in the article would prevail. The range of black-market price would be between OP and OB , PB being the addition due to price control.

This kind of elaborate analysis may be logical and theoretically satisfying. Empirically, they are too precise to be true. Perfect competition, which has been the bedrock of economic analysis, has now been acknowledged as being merely a limiting case of monopolistic competition. But, even under imperfect competition, no monopolist will ever hit upon the exact point at which his net revenue will be the greatest unless he has an accurate and enlightened system of cost accounting and a good knowledge of the market conditions in which he has to sell. Where we dwell is not the world of abstractions, nonetheless, we are not absolutely free from the influence of market prices. There are many social and human problems related fluctuations in price.

Impact of Price Mechanism

Price mechanism being the solar orb around which the economic cosmos revolves, it is but natural to expect that the impact of market prices would be extensive and profound. The study of price mechanism has so far only shown how the levels of output and price would be decided under market conditions. But, price mechanism is not only a phenomenon determined by various economic forces; rather it even regulates and guides

several important factors of the economic system. For this very reason, even in centrally planned socialist countries, the concept of "shadow prices" has been invented and many policy decisions taken on the basis of such theoretical considerations. Obviously, therefore, the importance of price mechanism in free economies cannot be too much emphasized.

Price mechanism may assist investment planning, prevent inflationary and deflationary pressures, ensure equitable distribution of income and property, and prevent and control anti-social rigging of the market. Such economic objectives may be achieved even by complex administrative regulations, but the superiority of price mechanism rests with its simplicity. A system of direct quantitative controls is the breeding ground for spivery and corruption. It is the father of black-markets and carries with it an insidious threat to public morality.⁵⁶ Economic administration in "inexpert charge" may have dangerous possibilities; the stake in such cases being human lives, social regeneration, and personal initiative and freedom. Any false step, which in fact, is more likely in such cases than not, might jeopardize the welfare of the people and dim the light of liberty for several generations to come. No system of economic regulations which corrodes the very root of social cohesion could be considered better than the simple apparatus of price mechanism. Under this mechanism, national resources, human as well as material, could be developed satisfactorily. Price mechanism reduces administrative proliferation, red-tape in economic regulation, and it eliminates almost completely the will of the single individual being subjugated to that of the collective entity often personified in democratically elected representatives. Inefficient price control in several circumstances may be more dangerous than pure chaos.

There are certain fundamental aspects of economic life on whose satisfactory progress depends the welfare of the community. Some of these aspects are employment, production,

⁵⁶J. E. Meade, *Planning and Price Mechanism*, George Allen & Unwin, London, 1949.

consumption, investment, risk-bearing, and initiative for establishing new undertakings, new innovations, and technological experiments and research. Obviously, these cannot always be satisfactorily developed if the system is cluttered with too many restrictions and hindrances. The progress in respect of these items would depend upon proper motivation of the people and upon their basic urges. By determining the levels of output in various lines of production, given the level of technology, price mechanism directs the labour force to the most appropriate lines of activities. It is only when monopolistic competition rigs the market that the feasible maximum employment is reduced. Under such conditions, socialization of the enterprise with proper pricing policy could reduce the defect. Price mechanism accompanied by the operation of the rate of interest might assist the economy in acquiring the appropriate level of capital formation and roundaboutness in industrial structure. Balance in the structure of production along with necessary adjustments to the changing conditions can thus be induced to create the best conditions in the society.

Even in order to achieve the most harmonious international economic relations, the importance of price mechanism is vital. Balance of payments, export performance, and efficiency in the production of internationally traded commodities are intimately connected with the availability of right kind of incentive, initiative, and competitiveness. Given fair opportunity to market prices to work out their influences, it may be possible to have effective control over internal demand, external capital movement, and adjustments in exchange rates. For every developing country, it is, therefore, important to keep a watch over the market mechanism and price behaviour.

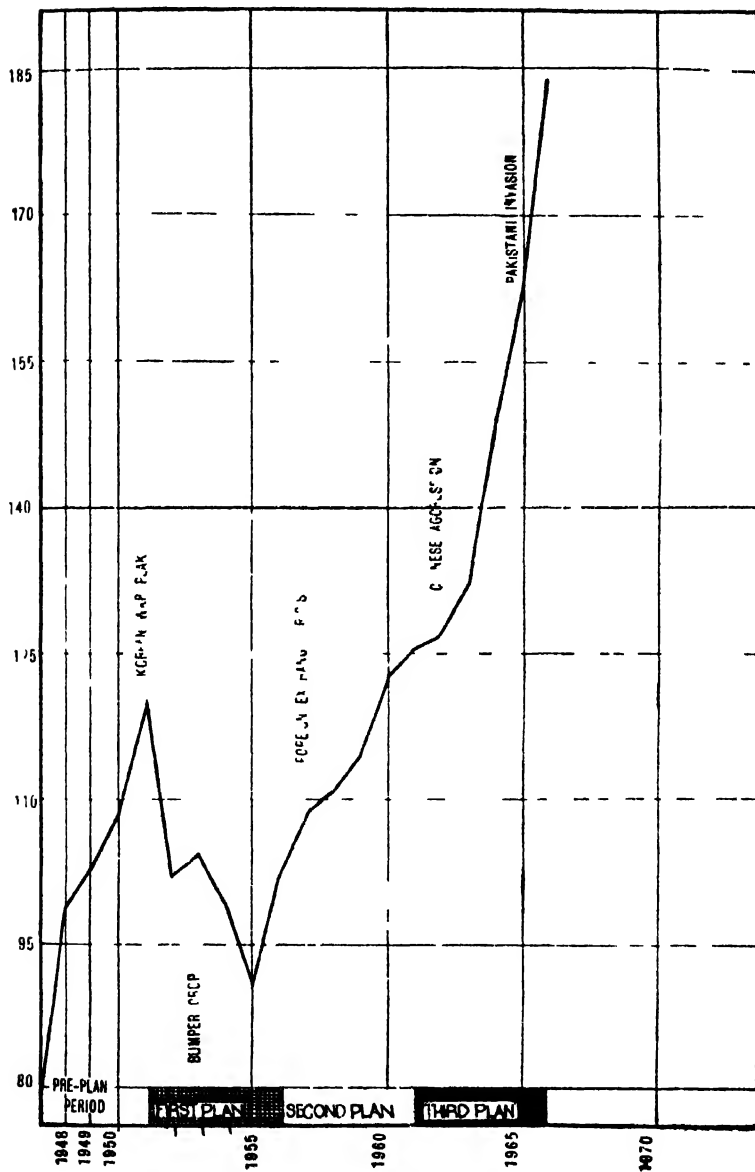
Many adjustment problems are easily solved by providing freedom to the market mechanism. Particularly, in a developing economy, several problems arise which are of a difficult nature. Here we do not refer to such problems like price control, rationing, direction of financial resources, grant of subsidies and other social security measures which have obvious relationship with

price mechanism, but we wish to draw attention to such additional financial burden which arise due to deteriorating law and order situation, administrative corruption, complicated financial and fiscal regulations, and increasing budgetary difficulties. Crux of the problem lies in psychological involvements of the administrators. The fact that the political authority to be effective must usurp economic power is expressed in a developing country by disrupting price mechanism so as to concentrate economic and political power together leading to authoritarianism of the worst anti-social variety. Many of the social evils of an early stage of economic development result from distortions of this natural economic apparatus. One of the problems facing democracy is to safeguard the freedom of market mechanism. Economists must be careful in analyzing the actual behaviour of the market prices. But it has also to be borne in mind that the application of theoretical apparatus in actual life is almost impossible. For this reason, it may be necessary to adopt a different approach. In order to see how complicated is the task of regulating market prices, let us examine the behaviour of Indian prices during the last twenty years or so, and see what are the forces working behind this phenomenon.

Behavior of Indian Prices

Since independence, there has been phenomenal rise in Indian prices. The index of general prices which amounted to 297 in 1947 as against 100 in 1939 reached a staggering figure of 675 in 1966. Such a steep rise in Indian prices would imply that a young Under-Secretary having joined the Government of India in 1948 would find that his salary of Rs 3,500 per month in 1967 having attained the highest official position of Secretary in a ministry, in real terms, is no preferment on what he received during the early years of his career. This is, indeed, a sad commentary on Indian progress. Even to the base 1952-53 as 100, when the Indian economy is said to have attained normalcy, the index of general prices rose to 183.5 in 1966. Chart I shows the trend of general price index since 1947.

CHART I
TREND OF GENERAL PRICE INDEX IN INDIA



From the chart, the ever-rising trend in general prices, excepting for the intervening period between 1951 and 1955, becomes evident. This spectacular rise is more pronounced if it is compared with international price index. The Indian prices have stepped out of accord with international prices. Many European countries such as France, Belgium, Germany (West), Italy, and the United Kingdom were seriously ravaged during the Second World War. The plight of Japan was no better. Nonetheless, Table 1 shows that these countries have done much better than India. Considering 1958 as 100, the index of wholesale prices in the United Kingdom increased from 77 in 1950 to 120 in 1966, in Belgium from 91 to 112, in Italy from 92 to 113, and in France from 64 to 123; the wholesale price index in Japan during the period increased from 71 in 1950 to 108 in 1966. The corresponding variation in Indian wholesale price index was from 95 in 1950 to 165 in 1966. The change in wholesale prices during the period as per cent per annum compound rate has been 3.5 for India as compared to 4.2 in France, 2.8 in the United Kingdom, 2 in West Germany, 1.3 in Belgium and Italy, and 2.7 in Japan. Compared even to other developing countries, India has been unfortunate: the per annum rate of increase in Pakistan has been 3.5 per cent whereas it was 2.6 per cent in the Philippines, 1.7 per cent in Thailand, and 2.5 in Egypt. The Indian condition has, however, been better than Argentina, Brazil, Chile, and such South American countries where runaway inflation has already seriously disrupted their economy.

The behaviour of Indian prices has been erratic. The estimated 3.5 per cent per annum compound rate of increase during 1950 to 1966 does not show the intensity of annual variations. The very first year of independence registered 23.6 per cent increase in general prices, whereas during the next two years, the rate of increase over the preceding year amounted to 3.8 per cent and 5.2 per cent respectively. Since then, the fluctuations have been distinctly disturbing. Chart II shows the annual rate of variation in general prices over the preceding

TABLE 1
INDEX NUMBER OF WHOLESALE PRICES
(INTERNATIONAL COMPARISON)

1958=100

<i>Country</i>	<i>1950*</i>	<i>1956</i>	<i>1961</i>	<i>1965</i>	<i>1966</i>	<i>Increase between 1950 and 1966 per cent per an- num com- pound rate</i>
Argentina	n.a.	61	292	767	921	32.0††
Belgium	91	102	100	110	112	1.3
Brazil	30	79	250	1925	n.a.	31.9*†
Canada	93	99	102	110	114	1.3
Chile	6	56	138	429	527	32.2
Denmark	82	101	102	115	118	2.3
Egypt (UAR)	82	93	102	113	122	2.5
France	64	85	110	121	123	4.2
Germany (West)	80	99	102	107	109	2.0
India	95	92	113	145	165	3.5
Italy	92	101	98	112	113	1.3
Japan	71	104	105	104	108	2.7
Netherlands	83	99	98	111	117	2.2
New Zealand	72	96	102	111	112	2.8
Norway	69	98	102	112	114	3.1
Pakistan	n.a.	n.a.	108	118	131	3.5††
Philippines	95	95	111	137	143	2.6
Sweden	71	91	105	120	124	3.5
Switzerland	93	101	99	108	110	1.0
Thailand	74	95	100	96	n.a.	1.7*†
United Kingdom**	77	96	104	117	120	2.8
United States	87	96	100	102	105	1.2
Yugoslavia*†	n.a.	99	106	130	144	4.7††

SOURCE: Monthly Bulletins of Statistics, United States.

*Deflated series.

**Finished products.

† Producer's prices of industrial products.

†† Compound rate of increase between 1958 and 1966.

*† Compound rate of increase between 1950 and 1965.

increased from 91.5 in 1955 to 183.5 in 1966 but that of food articles during the same period rose from 85.4 to 189.2, cereals from 73 to 165, edible oils from 81 to 288, and sugar from 95 to 160. Industrial manufactures have shown distinctly different trend from those of agricultural commodities. Fuel follows, more or less, the same trend as that of industrial manufactures, but agricultural items such as food articles, cereals, tobacco, and agro-based industrial inputs have, more or less, behaved identically; industrial raw materials since 1960 have, however, shown some differences.

Fluctuations in Indian prices have not been uniform throughout the country. Widespread availability of transistors and radios which broadcast market prices prevailing in metropolitan cities have, in fact, encouraged maintenance of high prices of several articles which otherwise could have fallen in different regions. Even the perishable articles such as raw and green vegetables and fruits, which should have been cheap in season in hilly and isolated regions, have been quoting high urban prices. It has not been possible even to establish uniform prices for a variety of other articles. Dr K. N. Raj has stated that the wholesale prices of wheat during the decade following 1955 have risen by 57 per cent in the Punjab, while the rise was twice as high in Madhya Pradesh, $2\frac{1}{2}$ times as high in Uttar Pradesh, and 3 times as high in Bihar.⁵⁷ The range of variations in the prices of several essential articles has also been substantial.

It has been noted that the range of variations in the wholesale prices of rice in different States amounted to Rs 45 to Rs 60 per quintal in 1950-51, Rs 44 to Rs 51 in 1956-57 but it rose to Rs 58 to Rs 92 in 1964-65. For wheat, the range amounted to Rs 26 to Rs 48 in 1950-51, Rs 32 to Rs 48 in 1956-55 but Rs 47 to Rs 96 in 1964-65; and for jowar, it has been Rs 26 to Rs 48 for 1950-51, Rs 32 to Rs 43 in 1956-57 but Rs 43 to Rs 64 in 1964-65.⁵⁸ Such variations have existed for other items

⁵⁷K. N. Raj, *Regional Disparities of Foodgrains Prices*, quoted in Gyanchand, *The Menace of Inflation*, Manaktalas, Bombay, 1957, p. 146.

⁵⁸Gyanchand, *op. cit.*, p. 145.

as well; they have prevailed so even during other periods. For example, in September 1955, the wholesale prices of coarse quality rice was Rs 11 per maund at Jagadapur in Madhya Pradesh, Rs 13 per maund at Balasore in Orissa, whereas in Contai in West Bengal, for the same stuff one had to spend Rs 15.50. In September 1961, six years later, the same amount of rice was sold for Rs 16 at Jagadapur whereas at Kumbakonam in Madras, the price was Rs 24, and in Balasore it was sold for Rs 17 and in Contai for Rs 18.50. In September 1964, Jagadapur sold the coarse rice at Rs 21.61 per maund whereas at Kalyan in Maharashtra, the price was Rs 33.58 per maund, in Balasore it was priced at Rs 25.37 per maund, at Contai Rs 24.02 per maund. Even in September 1965 the controlled price for coarse rice at Jagadapur amounted to Rs 21.75 whereas at that time it was Rs 24.46 per maund at Contai and Rs 38.91 per maund at Ranchi in Bihar. Similar variations have existed for wheat and other crops too.

Factors Affecting the Trend

There have been four main trends in Indian prices, namely, (i) changes in general prices, (ii) inter-commodity variations in prices, (iii) inter-temporal changes in price-level, and (iv) inter-locational variations in prices. Some of the motivating causes have been overlapping, yet it would be useful to examine them separately.

Variations of General Prices

The Marshallian equilibrium analysis discussed earlier has indicated that the economic cosmos can be stable only when the market prices have stability. The two sets of forces represented by the two blades of the pair of scissors representing demand and supply conditions have not during recent years in India been in equilibrium. The agricultural and industrial productions have failed to catch up with personal, industrial, and administrative demands. Social and political compulsions urging the government to introduce industrial regulations, consumption subsidies, protection of economic privileges, (uneconomic) p rice

needed to offset the *increased* pressure of population. The rising trend of foodgrain prices cannot, therefore, be attributed to increasing demand or due to any shortages of foodgrains. Increases in the demand for personal consumption of foodgrains do not explain increases in their prices. This, however, does not absolve the faulty distributive channels and such other difficulties.

Even the shortages of industrial production cannot be held responsible for causing increases in prices. Per capita availability of industrial goods, despite all shortcomings and inefficiency in this sector, has substantially increased. Net output of mining, manufacturing and small enterprises at 1948-49 prices amounted to Rs 1,480 crores which increased to Rs 2,110 crores in 1960-61 and to Rs 2,550 crores in 1964-65. The population in India is estimated to have increased from 361.1 million in 1951 to 439.2 million in 1961 and 498.7 million in 1966. On this basis, Rs 40.1 worth of industrial goods were available per individual in 1950-51, Rs 48 worth of such goods in 1960-61 and Rs 51.1 worth in 1964-65. Other things remaining the same, the industrial prices as a result of this improvement should have been falling. To the base 1956 as 100, the general index of industrial production has, however, increased from 74 in 1951 to 92 in 1955, 130 in 1960, 166 in 1963, 177 in 1964, 187 in 1965, and 192 in 1966. As against this, the wholesale price index for industrial manufactures decreased, to the base 1952-53 as 100, from 99.6 in 1950 to 99.4 in 1955 after which time it rose to 120.8 in 1960, 135 in 1964, 145.7 in 1965, and 159.9 in 1966. Both these indices show regular upward moving trend. This trend is observed in several other categories of industrial manufactures too. For example, the index of metal production, to the base 1956 as 100, increased from 54 in 1951 to 97 in 1955, 106 in 1960, 201 in 1963, 219 in 1964, 240 in 1965, after which it declined to 222 in 1966, but the wholesale price index for this category of item has also to the base 1952-53 as 100 increased from 86 in 1950 to 114 in 1955, 147 in 1960, 168 in 1964, 181 in

⁵⁹*Ibid.*, pp. 115-45.

1965, and 195 in 1966. Similar trend has also been observed in the case of production and wholesale price of machinery including electricals. Evidently, the supply of these articles cannot by itself be considered responsible for increases in their prices.

As is evident from the above description, the blade representing the supply schedule of the Marshallian pair of scissors has been inactive but the other one representing the demand side has in fact exerted a decisive impact. During the last two decades, the personal consumption, industrial demand for various inputs, and the requirements of the State for various items of production have substantially expanded. Increases in personal consumption have occurred both in real and monetary terms. Food items still now form 70.1 per cent of the rural, 61.4 per cent of the urban and 56.4 per cent of the city consumption expenditures. Price and income elasticities of demand for such items of consumption have been low. Consequently, the bulk of increased income is diverted to non-essential items of expenditure. During July 1959-June 1960, 38.6 per cent of the urban income was spent over non food items, which increased to 40.38 per cent during February 1963-January 1964. Increases in income have taken place in rural areas as well, transistors and terylene have penetrated into rural regions and their per capita expenditure has been increasing. During the four years of 1960-64, per capita monthly expenditure of rural population increased from Rs 20.03 in 1959-60 to Rs 22.31 in 1960-64.

Nonetheless, the substantial push has originated from urban consumers whose number as well as income have increased. The rural population, particularly attracted by employment opportunities in urban areas, has been migrating to those regions. The percentage of urban population which accounted for 13.9 per cent of the aggregate in 1941 increased to 17.3 per cent in 1951, 18 per cent in 1961 and by 1970 it might be around 19 per cent. This has to be considered along with the fact that the level of urban expenditure has been higher than in

rural areas—per capita monthly rural expenditure in 1959-60 has been Rs 20.03 as against Rs 27.51 for the urban areas and Rs 40.37 for the four main cities—which has been recently rising further making the gap between them wider. The corresponding consumer expenditure in 1963-64 amounted to Rs 22.31 for rural areas, Rs 32.96 for urban and Rs 52.03 for the cities. During this period, the rural expenditure on non-food items decreased from 29.9 per cent of the total to 29.75 per cent whereas for the urban areas it increased from 38.6 per cent to 40.38 and for the cities from 43.6 per cent to 45.56 per cent. In this context, it may, however, be suggested that the impact of changes in consumption pattern in India has not been adequately reflected in the price changes of many essential items due to various rigidly enforced markings on factory products particularly in the case of textiles, drugs, and similar other articles.

The urge to industrialize the country has very much activated the demand for industrial inputs and manufactures. Even now, a large number of industries, e.g. cotton and jute manufactures, sugar, tea, and coffee industry, are agro-based. Any increase in demand for these articles would increase the pressure on land. Special emphasis laid on food production has further intensified the concern about proper utilization of land. As a result of higher priority to agricultural development, it has been necessary to increase investment in diesel pump making enterprises, fertilizer factories, and chemical formulations. Agricultural implements, transport equipment, and other items connected with agricultural development have also to be provided for.

In order to supply the agricultural requirements and to meet the growing demand for industrial products, the manufacturing sector of the economy has during the last two decades been expanded and diversification of production incorporated. India has now been able to produce items like ball and roller bearings, electric transformers, machine tools, textile machinery, power driven pumps, diesel engines, and automobiles. Even loco-

tives, aircrafts, defence equipment, atomic power generation, and electronic equipment have made spectacular progress. The setting up of petroleum refineries, steel plants, and shipyards have significantly added to the industrial strength of the country. Even in small-scale sector, higher and sophisticated technology has been introduced leading to considerable expansion in the scope of its activities.

Encouragement to industrial development has been given not only for meeting the domestic demand, but also to meet the challenge of export markets and to implement the import substitution programme. Establishment of such enterprises which have primarily taken place in urban regions has increased the demand for such agricultural products as cotton, jute, oil-seeds, tea, coffee, besides minerals like iron, manganese, mica, copper, etc. With increases in the tempo of industrialization, the demand for machinery, components, and parts has also increased. The manufacturing sector has now to meet the increasing demand generated by (urban) personal consumption, agricultural development, industrial requirements, import substitution programmes, and export markets. Evidently, they exert substantial pressure on the industrial sector.

Increasing Government Expenditure

Since Independence, the requirements of State have also expanded much. The expanding scope of administration as well as the urgent demand for social security measures have already led to proliferation of civil servants and have expanded the government activities. An idea of this expansion in activities can be had from the fact that the total employment in the public sector has increased from 5,234 thousand persons in March 1956 to 9,263 thousand persons in December 1965. Of this, 3,033 thousand persons in 1956 and 4,919 thousand persons in 1965 were engaged in services only. Non-developmental revenue expenditure of the Centre, States, and Union Territories combined together amounted to Rs 508.7 crores in 1950-51, which increased to Rs 617.3 crores in 1955-56, Rs

Far-reaching changes have begun in rural economy. Occupational pattern as well as consumption habits of the rural population have been changing. Roads have opened the interior of villages and jeeps, buses, and trucks have reached the far and distant places. The level of education has risen. Better health facilities have become available. As a result of these changes, a new revolution is afoot. Under the various programmes of rural development, financial and technical assistance have been provided to rural artisans, craftsmen, farmers, and agriculturists. Consequently, much money has been sunk in Indian villages.

This tendency has been accentuated by another factor. The industrialization programme of the country with a large number of huge factory establishments and other employment opportunities being opened in urban areas has induced emigration of rural workers to urban centres. Large movements of rural population to industrial establishments and to metropolitan jobs have, however, generated return flow of income to rural areas. It is difficult to estimate the volume of such return flows, but it may be obvious to any visitor that the rural economy, despite being highly non-monetized as yet, has been receiving the impact of substantial monetary invasion. Individuals as well as rural families have received large amount of money. This has happened when the expenditure opportunity of these families has been very restricted. Scope of expenditure on essential items has been limited. The level of consumption of foodgrains and other food articles, clothing, furniture, books, soaps, and such other articles has altered insignificantly. Private construction activities have not been encouraged to the desired extent either. With the rising levels of income, larger expenditure on house building, furnishing and sanitary fittings is inevitable but in Indian villages, despite assistance provided to brick-building (kiln) activities, the private constructional activities have been stagnant. Many difficulties have been present to this kind of activities. To name a few, difficulties with regard to the supply of cement, steel, timber, and other cheap and suitable house-

building materials and designs, besides apathy, lethargy, and disincentive, have made the villagers content with their miserable dwellings. This has happened when public buildings for panchayat, community halls, police stations, and schools have been coming up. To some extent, these buildings have made the villagers think that such buildings are primarily intended for public purposes only and these cannot meet the needs of the common people for their personal use.

Meanwhile, the villagers have acquired money much in excess of their daily requirements. A portion of it mobilized through a few commercial rural banks and other financial institutions has been available for investment outlays, but the portion remaining with the rural rich individuals, in absence of expanding legitimate expenditure opportunity, is spent over ostentatious items such as transistors, radios, terylene, watches, bicycles, as well as on liquor, tobacco, and beverages. These items are not essential items but expenditure on them has been induced by the availability of purchasing power in certain hands. Due to political and administrative difficulties, the mobilization of rural savings has not been effective. Consequently the surplus rural money flows towards the purchase of whatever is available of urban manufactured sophisticated goods. This has added to the inflationary pressure on such articles and ultimately on the national economy.

The rate of urban expansion and the increasing availability of accounted and unaccounted money have also accentuated the inflationary trend. The relative share of agricultural yield in the national income has been declining whereas that of other services which reflect the expansion of various types of urban activities has been increasing from 15.7 per cent in 1950-51 to 18.1 per cent in 1960-61 and 20.9 per cent in 1964-65. This suggests that the urban income has been rising faster than the rural income. Furthermore, the inflationary situation and other commercial transactions have led to transfer of income in more than one ways from the salaried to non-salaried class. Black-marketing, smuggling, and the availability of unaccounted

certain special causes.

Inter-locational Variations

We have indicated earlier that the market prices do not behave uniformly throughout the country. The explanation in terms of overall growth in demand would need modifications in order to explain inter-locational variations. An important fact which is often ignored in this context is market imperfection. Possibility of different prices being charged by the same producer in different markets has been mentioned earlier. That condition is very well exemplified in Indian economy. India is indeed a colossal country consisting of a large number of isolated markets. There are areas of the country which are inaccessible during a large part of the year. Transport facilities are still very primitive in many parts of the country. There are pockets in Himachal Pradesh, Madhya Pradesh, Maharashtra, NEFA, Rajasthan, Assam, and Bihar which are not well connected with important commercial centres. In fact, every rural and semi-urban centres have characteristics of isolated markets. Unless goods and services flow freely from one part of the country to another, such regions have to be treated as separate isolated pockets. Therefore it is natural, depending upon the nature of commodities, to expect that variations in their prices from one such centre to another may be significant.

This imperfection is further accentuated by several governmental restrictions. Inter-locational variations in prices have been mainly with regard to agricultural crops. These items have been subjected to various regulative practices. Such controls have been introduced with a view to tackling the problems of different commodities and meeting the regional requirements. In order to create buffer-stocks so that any shortages arising in any specific zone could be mitigated effectively, the government has introduced procurement drives. Several States have participated in this scheme. But, the prices offered by different States are not the same. Moreover, several surplus States have been grouped together in different zones so as to restrict the move-

ment of food-grains from one zone to another. As a result of such restrictions in transportation and as a result of the payment of different procurement prices in different States, one cannot expect the prices to be uniform all over the country.

Imperfection in rural markets has been accentuated by another factor as well. Most of the transactions in these areas are carried out on barter system. Even presently, about 80 per cent to 90 per cent of the village produce is used in local transactions for paying to labourers, artisans and for purchasing other essential items of daily use. This characteristic of the rural economy enables stability of prices to a great extent there, whilst it insulates the economy of the region from exogenous monetary invasion.

Inter-Temporal Variations

The last twenty-year period may be classified in two broad periods with April 1955 as the dividing line when the prices had attained the rock-bottom. The period preceding this line is characterized by four main features, namely, (i) decontrol-control-decontrol in food policy of the country, (ii) devaluation of pound sterling in 1949, (iii) outbreak of the Korean War, and (iv) the formulation and implementation of the First Five Year Plan of India. The subsequent period is characterized by the foreign exchange crisis, stability in prices, Chinese aggression, Pakistani aggression, and the devaluation of the Indian rupee.

Decontrol-Control-Decontrol

The policy of decontrol adopted in December 1947 did not come up to expectations initially entertained in regard to an improvement in the supply situation through increased production and dehoarding. The food situation continued to be difficult. During 1948, the cereal production in the country declined by 11.1 million tons, declining from 48.9 million tons in 1947 to 37.8 million tons in 1948. Between April and August 1948, the index of food prices rose by 15 per cent; the increase amounted to 29 per cent for the period November 1947 to

July 1948. The rise was all round, all the constituent groups showed increases, but the rise was most marked in the case of decontrolled items. Cereals in the food group showed an increase of 49.4 per cent, oil-cakes and cotton yarns 99.1 per cent and 76.3 per cent respectively, and textiles 42.5 per cent. Decontrol thus led to a release of latent inflationary pressures which had adverse impact specially on the articles of mass consumption. The Government of India, therefore, decided on a gradual reversal of the policy of decontrol. A beginning in this direction was made in July 1948 and by October 1948 the government announced a full-fledged anti-inflation programme. The measures adopted in pursuance of this policy aimed at keeping the government expenditure—central as well as that of States—as low as possible consistent with efficiency, reducing the excess purchasing power in the hands of the community, and at increasing the volume of essential goods and services.

Devaluation of the Pound Sterling

Before any significant impact of these measures could be visible, another set-back by way of devaluation of the pound sterling occurred in September 1949. Following the devaluation of the pound sterling, the Government of India devalued the Indian rupee in terms of the U.S. dollar from 30.225 cents to 21 cents and in terms of gold from 0.268601 grams to 0.186621 grams of fine gold. Consequently, the rise in wholesale prices particularly due to the higher cost of dollar imports in terms of Indian rupee and the rise in the prices of certain imports which though originating in the Sterling Area yet were marked up following devaluation in view of their importance and capacity as dollar earners was but natural. Intensity of such consequential rise in prices was further accentuated by the fact that the imports of foodgrains, industrial raw materials, and machinery, which were quite substantial in India even at that time, began to cost more. It was also feared that devaluation would lead to a rise in the rupee prices of several export goods.

the supply of which was relatively inelastic. In order to fight such tendencies an eight-point programme aiming at holding the price-line and conserving the country's resources in foreign exchange was announced in October 1949. But despite the various precautions, the prices continued to rise and by September 1949 the prices which had already exceeded the post-decontrol peak continued climbing further so that in March 1950 the general price index was higher than the pre-devaluation figure, though this rise was not as high as that in the United Kingdom. The increase in the general index during 1949-50 was 6 per cent relative to the level at the close of the preceding year.

Korean War

Before the impact of devaluation could be absorbed in the economy, the Korean War broke out in June 1950. This created further strain on the economy. Prices all over the world soared high. The question of stock-piling necessary for the successful completion of the war was inextricably linked with price-rise. For India, it also meant severe strain on her economy due to larger imports of (i) machinery and parts, (ii) non-ferrous metals, and (iii) raw cotton on which the United States due to its own reasons had imposed higher export duty. Imports of petroleum products following de-rationing had also increased. Consequently, by June 1951, the wholesale price index to the base of 1952-53 as 100 increased from 108.4 in June 1950 to 126.4 in June 1951. With the cessation of the Korean War the following year and with the introduction of tight credit policy the prices began coming down.

Planning in India

During the same period, India was also preoccupied with the task of evolving its own development strategy. In March 1950, the Planning Commission was set up with a view to formulating plans for effective and balanced utilization of the national resources. Draft First Five Year Plan was prepared in July 1951. The total outlay during the First Plan period was envisaged at Rs 2,069 crores in the public sector which was

subsequently revised upwards to Rs 2,356 crores in order to accommodate the programmes intended to meet the growing unemployment situation in the country and to include certain other projects for flood victims and some other schemes

As a result of the implementation of the First Five Year Plan, the supply position in the country greatly improved. During the First Plan period, the foodgrains production increased by 20 per cent and the output of cotton and major oil-seeds by 45 per cent and 8 per cent respectively. Even the industrial production increased by more than 53 per cent during the Plan period. Prices at the end of the First Five Year Plan, in fact, came down so much that they were 13 per cent lower than the level existing at the time of the inauguration of the plan, or even lower than the pre-Korean War level. The First Plan indeed had a stabilizing influence on the Indian economy, which expressed itself in downward trend of prices. Following the restoration of some measure of stability in prices during 1952-53, a recession set in which deepened during the next two years. This was so particularly as a result of a succession of unusually good harvests. Indeed the year 1955 showed the minimum prices ever reached during the last two decades.

Second Plan Period

Since April 1955, when the wholesale price index to the base 1952-53 as 100 reached the lowest level of 88.9, a new trend began making the prices ever rising till it reached 208.3 in May 1967. During this period, however, several aggravating factors set in. Some of these have been the foreign exchange crisis of 1957-58, the Chinese aggression of 1962, the Pakistani invasion in 1965, and the devaluation of the Indian rupee in 1966. These have given sharp upward turn to the price-line. Over the five years of the Second Plan itself, the wholesale price index showed a phenomenal rise of more than 30 per cent, food articles as a group rose by 27 per cent, industrial raw materials by 45 per cent and the manufactures by over 25 per cent. During the Third Plan period, the same trend continued showing the

rise in wholesale price index from 122.9 in 1960 to 183.5 in 1966, and food article prices rising from 120.2 to 189.2; the index of industrial raw material prices rose from 138.8 in 1960 to 219.4 in 1966.

Professor B. R. Shenoy of the Gujarat University, in April 1955, while dissenting with the other members of the Panel of Economists, had very rightly cautioned the government against the size of the Second Five Year Plan and against using deficit financing as an important source of financing it. Deficit financing of the order envisaged in the Second Plan was "clearly inflationary." Professor Shenoy emphasized that "inflation tends to be self-perpetuating. With the rise in prices and wages, the original estimates of the cost of the projects taken in hand will be out of date. More deficit financing would be necessary for their completion."⁶¹ Towards the conclusion of his note, Professor Shenoy mentioned that "price support and deficit financing were no remedies to individual overproduction, to export difficulties attributable to quality and to domestic cost, or exchange over-valuation. Price support and deficit financing, in fact, aggravate the maladies."⁶² There were others like P. T. Bauer, Milton Friedman, and Ragnar Nurkse, who considered the magnitude and priorities of the plan not helpful for the country. Subsequent trends of events have, however, proved the prognostications of these economists to be correct.

Soon after the beginning of the Second Plan, the country was bogged up in foreign exchange crisis. Import prices went up, and the shortfall in domestic agricultural output further aggravated the situation. In 1957-58, the production of foodgrains was 6 million tons less than in the previous year. In 1959-60, again, foodgrains production was about 4 million tons less than the previous year. The output of cotton in that year was 18 per cent below that in the previous year; that of jute was 12 per cent lower and that of oilseeds was short by about 6 per cent. These

⁶¹B. R. Shenoy, *op. cit.*, p. 9.

⁶²*Ibid.*, p. 12.

shortfalls and fluctuations in agricultural production reacted adversely on the price level as a whole.⁶⁶ As warned by Professor B. R. Shenoy, the inflationary situation necessitated a reconsideration of the Second Plan which was revised upwards in order to meet the estimational error and increased cost requirements of the various plan projects. Inevitably, the price situation was further strained.

The trend in prices experienced at the opening years of the Third Five Year Plan got seriously disturbed by the Chinese aggression in October 1962, followed during the subsequent years by the Pakistani invasion, famines, droughts, and other national calamities. After the Chinese aggression, there has been a sharp rise in prices. This was but natural. Strain on individual production, large amount of deficit financing, and mobilization of material resources for defence objectives were bound to create shortages and increased demand pressures. Many inefficient production units came up simply with a view to encouraging import substitution programme. In government purchases, which, in fact, during the emergency had been substantial, greater price preferences were accorded to socially desirable though economically inefficient enterprises. This had inevitable consequences on price rise.

But by 1964 when the economy was getting stabilized, further explosion occurred due to Pakistani invasion of India. The prices had been declining in March 1965, when the general index had declined from 158.6 in September 1964, to the base 1952-53 as 100, to 151.5 in March 1965 and that of foodgrains had declined from 169.5 to 154.4 over the period, but the Pakistani invasion aggravated the difficulty. After September 1965, the Indian prices began rising very steeply. Every year the prices went on eating into the real value of money.

Then came the devaluation of the Indian rupee in June 1966 with one of its announced objectives being the restrain over the inflationary price rise. Devaluation, however, has failed to attain

⁶⁶*Third Five Year Plan*, Planning Commission, New Delhi, p. 123.

its objective at least in this regard. A year after this momentous decision, in May 1967 the general price index was 208.3 as compared to 181.6 in May 1966, the food index amounted to 228.8 in May 1967 as against 185.7 in May 1966, industrial raw materials 234.8 as against 220.7, and that of manufactures 168 in May 1967 as against 159 in May 1966. The prospect of a bumper harvest during 1968 expected to relieve the price situation has, however, belied the hopes. The future course of events would depend to a great extent upon the nature, priority, magnitude, and the implementation of the Fourth Five Year Plan. But, the Fourth Plan in its turn would depend upon the state of economy prevailing in the country.

Recovery

It is important that India recovers soon from her price setbacks. Unless the seriousness of the problem is realized and all-out efforts made for its stability of the economy would be difficult to achieve. As indicated earlier, price mechanism is the centre of the economic cosmos; unless the price mechanism is restored to discharge its natural responsibilities, other economic activities would fail to make an impact. The strength and vitality of any economy can be gauged by the prevailing market prices. During the normal course of events, the market prices would activate the various economic forces so as to produce the best consequences on the economy. Many of the regulatory and extension measures of the State would then become redundant and the employment of human and material resources would attain the optimum level. Unless stability in market prices is attained, the individual consumer would find it difficult to make articulate his schedule of preferences, the uncertainty would make even his behaviour indeterminate. This would arouse immense dissatisfaction in the society. No individual can function efficiently in a situation of constant insecurity. This breeds social tension. It is reflected in individual's efficiency in work. It destroys family harmony. It distorts future expectations. Individual is the central pivot of the human

society; economic system exists for his convenience and advantage. In a situation of ever-rising price spiral with no end in view, his horizon of economic expectations is so much beclouded that he behaves like a gaol-inhibited neurotic. That is too bad for any society.

A situation of price instability may be tolerated as a transient evil if the future is bright and the price rise is deliberate and purposive. Such conditions often occur during the early phases of economic development. But, when the situation goes out of control, even recovery becomes difficult. Economic and social consequences of the rising price-spiral create wrong preferences, distort market supplies; income expectations do not harmonize with the desirability of that profession; black-marketeers and smugglers thrive better, and a new class of the *nouveau riche* is born whose interests are served better by perpetuating the abnormal conditions. The pattern of agricultural and industrial productions, the fiscal and monetary system, and the international trading relationships become so much out of tune with the normal condition that the return to normalcy becomes a stupendous task. Immense administrative impediments arise in restoring the price mechanism to the best social advantage.

Though difficult, yet not impossible is the task of economic recovery. Many war-devastated nations have successfully rebuilt their economies. Examples of France, Germany, and Japan have been spectacular in this regard. France has been an illustration of recovery from a state of utter destruction to a position of international power within a few years of the cessation of the Second World War. The German restoration has been no less spectacular. Germany had fallen to an extremely low level. The paralysis of the price-mechanism was primarily to blame for it. Money was worthless; factories closed down for lack of materials; trains could not run for the lack of coal; coal could not be mined because miners were hungry; miners were hungry because the peasants would not sell food for money and no industrial goods were available to give them in return. Prices were legally fixed but little could

be bought at such prices; a black market characterized by barter of fantastically high prices existed. But, in 1948, the German economy did create a "miracle." The price mechanism was set in order. Almost immediately afterwards, production and consumption soared high, and the country could reverberate with industrial activities. Japan has also achieved similar results. The tempo of industrialization in Japan has been rapid. Freedom of initiative and confident economic opportunities have not only restored the Japanese economy to the pre-war level, they have also given new strength to it.

These examples suggest that the Indian recovery can be possible provided a serious effort is made. Clear understanding of the problem, earnest determination for recovery, and appropriate readjustment of the economic system are basic requirements for achieving the goal. Many impediments have, however, been created by vested interests. At the very outset one is confronted with a plethora of arguments supporting price control. This is due to self-interestedness of a large section of population who derive undue advantages resulting from the situation. Agriculturists, industrialists, businessmen, retailers, contractors, officers engaged in economic administration, and those who have political power to subjugate economic system to their own end would vehemently oppose restoration of the price mechanism. This psychological involvement has very extensive ramifications. Unless the ground is cleared, and the necessity for price stability well recognized, no serious efforts can be made in this regard.

Consumers' Sovereignty

Once the urgency of price stability is acknowledged and the various steps involved in it recognized, it would be necessary to seriously examine the five basic considerations which could assign the price mechanism the role it rightly deserves in any free society. First, *the consumers' sovereignty must be acknowledged.* This is the most important consideration to be taken into account. No economic development, industrial transformation, or techno-

logical improvement is desirable by itself; they are all needed because they help the individuals in satisfying their needs. This can happen only when appropriate importance is assigned to the individual consumer. Consumers' sovereignty is as vital as freedom of thought and freedom of expression. Human society has shown, though with apparent good intentions, extreme brutality by coercing intellectuals and scientists for their forthright expressions. Such situations must be eliminated at all costs. In the sphere of economic development, it can happen only when the benevolent and welfare doctrinaire controls and regulations of market mechanism are eschewed as far as possible. This implies a very careful examination of the expanding scope of the public sector activities.

The role of the State in the economic life of a community must be given a serious objective thought. An enterprise by mere change of ownership from the individuals to the direct control of parliament, that is by transferring the unit from the private sector to the public sector does not ensure efficient working in the best social interest. Statism must be watched carefully. The ideal of social welfare should be applied with caution and commonsense; any doctrinaire approach may be prejudicial. The Indian experience as well as that of several other countries in corruption and breakdown in law and order situation may also be related, to a great extent, to the possibility of acquiring by some individuals or some groups of individuals undue gain in national wealth without putting in legitimate labour for the same. Consumers' sovereignty provides maximum opportunity for the free expression of one's choice-preference. One must get the reward for one's efforts, one must be able to use the same in any way one likes, of course, after paying to the Caesar what is due to the Caesar. The individual must be respected. Economic development must be geared to satisfying the needs of the individual consumer. If this objective is accepted and attempts are made to instal the individual to his rightful position, all other requirements of the economy would automatically be satisfied.

Agricultural Reorganization

Second, *the agricultural sector of the economy should be given due importance.* Agriculture should be assigned the highest priority. But this is a very vast and a very complex task. There are two sides of the problem. Firstly, the agricultural operations should provide adequate and fair return to the farmers. This is the social aspect of the problem. The rural life of the country depends on agriculture. There must be fair return to this sector so that the large bulk of population may hope to secure a good life and a better standard of living. Secondly, the yield of agriculture, the pattern of cultivation, the distribution of the output, and the prices of the various commodities produced should be so adjusted that the economy as a whole gets proper incentive for further development. Prosperity of agriculture and fair wages to the agriculturists should be able to activize economic development of the country as a whole. A detailed agricultural plan accompanied by a programme of rural industrialization is necessary in this regard. To give an example of this approach, it may be indicated that the sugar industry fostered by protection for more than thirty years or so has failed the country because some of the basic principles have been neglected in this connection. The price of sugar has been rising internally and is out of tune with the international prices. Sugar cultivators are heavily subsidized. Those who consume indigeneous sugar are unduly burdened on this accord. A perpetual burden of this sort has no moral justification. Furthermore, sugarcane is an exhaustive crop and it directly competes with paddy cultivation. Increasing acreage of sugar induced by artificial price for the same has led to shrinkage in the area of paddy cultivation thus damaging the opportunity of self-sufficiency with regard to foodgrains. Food shortages raise food prices, cause increased imports, raise the cost of production of industrial goods and perpetuate the rising spiral of market prices. Why should sugar protection not be eliminated? This and several similar other problems must be objectively considered in view of the long-term gains to the country. Unless

agricultural development is thoroughly reoriented and right policy adopted with regard to it, all other prices would be distorted.

Productive Public Expenditure

Third, *the expenditure policy of the government should be production oriented.* Presently, much money is spent over non-productive items. This is very harmful specially during an inflationary situation. This aspect of the problem is full of dangerous possibility. Any one who criticizes the various items of public expenditure may incur the wrath of many powerful individuals and he may be dubbed as reactionary. But an on-the-spot study of the government expenditure on economic and non-economic heads might indicate that a high proportion of the same has been on non-essential items. The economy rules must be realistic; the amount of expenditure must be related to direct advantages accruing from it. For example, extension of railways track is more meaningful than building the passenger sheds, the increase in the number of buses is more helpful than screening the already constructed bus sheds. Similarly, economy in travelling is more meaningful than coercing the individual civil servants to spend money out of his own pocket on tours. Similar examples of economy and non-essential expenditure may be cited from various government departments. The main idea of this point is to highlight the need for securing tangible gain for every rupee spent on government account.

Quality of Administration

Fourth, *the quality of administrators should improve.* Aristotle thought of a separate breed of administrators. That would have been an ideal. Nonetheless, the expanding role of the State emphasises the fact that a general administrator, a technocrat and an economic administrator having different functions in a developing society must have different service conditions suited to the particular sphere of their activities. This evidently would involve a distinct reorganization of the government

departments and of the officials working there. A government servant who is troubled about obtaining his ration, who is insecure about his future prospect, who is coerced into humiliation by his superiors and by his counterpart in the private sector employment cannot hope to function satisfactorily. The changing role of the State, particularly in the sphere of economic development, and the inclusion of technocrats and specialists in its employment should require a comprehensive reformation of the service code: patchwork amendments would not help. The government servants are expected to be honest, but the word "honesty" has a moral connotation as well as an economic implication. No one should *expect* any kind of *unearned* reward, but that can happen only when a new philosophy of action is inculcated.

Proper Motivation for Social Action

Lastly, *the question of proper motivation for social action would have to be appropriately considered.* The State should aim at arousing the right kind of enthusiastic entrepreneurship. But it would be difficult to define what that right kind would be. Better economic community can be created only when economic distortions are eliminated. Anxiety with regard to black marketing and concentration of economic power and creation of shortages leading to further shortages in the economy can be eliminated only when the industrialists and the businessmen are discharging their role properly. This will require a social reorganization. Once proper motivation with appropriate administrative machinery has been aroused, social reorganization would not be difficult to attain. In that set-up, most of the business evils and causes for industrial retardation such as gheraocs, strikes, and lock-outs would automatically be eliminated. Problems of prices in that case would not merely be objectively investigated but the policies relating to it could be effectively implemented too.

CHAPTER II

DEFICIT FINANCING

ONE of the main causes of high prices in India has been large doses of deficit financing. In this chapter, we shall discuss the nature and implications of this problem.

Significance of Deficit Financing

The essence of deficit financing lies in the fact that the State has been assigned certain responsibilities which cannot be satisfactorily discharged unless it is granted immense financial power without any let or hindrance. In order to mitigate a large number of economic difficulties, and to promote many important welfare programmes, it is necessary that the government functioned beyond the traditional limit of maintaining law and order. Industrial fluctuations, sudden foreign aggression, and colossal developmental efforts cannot be effectively tackled unless the government is granted adequate financial resources. Deficit financing is that mechanism by which the government can urgently mobilize a vast amount of domestic resources. This unilateral action of the government, however, can have far-reaching consequences; it affects transfers of income, structure of prices, efficiency of investment outlays, stability of industrial organization, harmony in labour market, and adjustments in social organizations. Deficit financing is indeed a powerful means of financial control which has been granted to the State so that it can fulfil its vital obligations to the community.

This fiscal mechanism has been assigned during the present age a positive role. This has happened due to the growing integration between the political and the economic functions of the State. In earlier times, the State had merely a regulatory function and as such the fiscal policy was not directed towards raising resources so much as controlling and regulating the economic forces. This

approach was based on the contemporary philosophy demarcating the spheres of action for the individual and the State. The Classical *laissez-faire* doctrine which epitomized the prevailing mood, was based on the assumption that economic harmony was attained as a result of free operation of the self-interest of the individuals. A conclusion drawn from this principle was that "the very best of all plans to finance was to spend little and the best of all taxes was that which was the least in amount." Since full employment, optimal allocation of resources, and equitable distribution of income can be attained automatically through the operation of the free economic forces, the classical economists thought the fiscal operations to be non-regulatory in character.

The advent of the Marginalists reinforced the restrictions imposed on the State. Such theories derived strength from the Social Contract Theory of the origin of the State which enunciated that the primary function of the State was to ensure freedom of the individuals. This philosophy served well until the early phases of Industrial Revolution. When the creaks began to appear in the economic fabric and the various forms of socialist philosophy began to be discussed a new adjustment became imminent. After the First World War, the condition of the world radically changed. First as expediency, and later as a logical necessity, the expanding jurisdiction of the State activities began to be justified. The contribution of Sir William Beveridge in making the people social security minded greatly contributed towards this end.

Neo-Classical economists such as Alfred Marshall and A. C. Pigou restated the theory of State action. They showed how the natural harmony of the classical age got impeded in the modern society, which could be set right only by governmental interference. Professor Pigou analyzed the various hindrances which obstructed the maximization of national dividends; under the free economy divergences occurred between the private and the social returns. Such divergences could be remedied by correcting the misdirections of national resources. Mrs Urshulla

Hicks has argued further that the basic objectives of fiscal policy should be related to production and utility optimization in the economy. Thus, the approach to fiscal policy has radically altered during the last hundred years and deficit financing has been recognized as a justified tool in the hands of the State for achieving its economic and social objectives.

During the last thirty years or so, even the expediency of circumstances has reinforced the importance of deficit finance. This has happened due to war financing. The Second World War revealed a new aspect of the problem. Other fiscal devices such as taxation, public borrowings, and compulsory savings were freely employed during the period of emergency, but there have been occasions when war-time expenditure necessitated deficit financing. Ordinarily, deficit financing is avoided when the level of aggregate demand in the community is high. When there is full employment in the community, and there is shortage of industrial capacity, when inventory accumulation is depleted and capital formation is at a low level, deficit financing is not advisable. But the emergency created by war requires quick mobilization of a large amount of domestic resources. It is for this reason that deficit financing was favoured to other methods of raising resources. Deficit financing is quick and it can be based on the unilateral action of the government. War, whether it is defensive or offensive, once decided has to be carried out despite every impediment. This great urgency for finance and the suitability of deficit financing for this purpose has made it a useful weapon in the armoury of the government.

Importance of deficit financing has certainly increased since the Great Depression. Professor J. M. Keynes provided the economic justification for the same. The New Economics under the impact of the Keynesian *General Theory* provided the framework for compensatory fiscal policy. Professor Keynes providing a radically different framework of economic analysis emphasized that the competitive process of the capitalist system did not necessarily ensure adequate aggregate demand such as to offer fruitful employment to all productive resources.

Private savings and investments are not of the adequate level so as to provide proper utilization of the existing resources unless the level of consumption also rises. Such deficiencies in aggregate effective demand which lead to lowering of the level of employment and consequently to decline in national income could only be corrected by the State through pump-priming. But this should be purely a temporary device intended to relieve economic depression. According to the pump-priming theory, the deficit spending resulting from it would initiate primary and secondary increases through the multiplier effect which would raise the level of employment and income. In this way, deficit financing has been argued to assist recovery. It was under the impact of this theory that the massive State expenditure in the United Kingdom and the New Deal measures in the USA could be taken up.

The emergence of a large number of underdeveloped countries as independent nations, during the post-Second World War period, which have been eager to develop their economic resources has further accentuated the significance of deficit financing. These newly independent nations have been impatient to industrialize and to raise the standard of living of their people. These objectives have been laudable but the means for achieving these goals have been very trying. Despite limitations, they have launched many ambitious programmes of economic development. This has been a stupendous task for which almost all forms of domestic and external resources have to be mobilized. By the very nature of their economy, the availability of internal resources has been limited. No amount of external assistance can eliminate the need for mobilizing domestic resources; both have to function together, and both are necessary ingredients of development finance.

In view of the difficulties experienced in mobilizing internal resources through the usual channels, deficit financing as a means of raising internal resources has become a common feature of most of the developing countries. But this by itself creates several other difficulties. The management of deficit

financing being under the jurisdiction of political representatives of the people throws the control of this powerful weapon in the hands of non-technical persons. In a country with not much advanced technical and economic training, the masses often fail to understand the implications of various industrial, monetary, and fiscal policies. As such, they are unable to safeguard their own interests. The elected representatives also being human are likely to indulge in liberal expenditure of the public fund. This often leads to avoidable public expenditure. Even the excessive zeal for initiating economic enterprises without appropriate evaluation of cost-return possibilities of the units sometimes leads to social risks and wastages. Such dangers exist whenever parliamentary form of government fired by the ambition of rapid industrialization of the country is entrusted with the control of deficit financing. This happens because no fool-proof check against the use of printing press has yet been evolved.

Thus, one observes that the significance of deficit financing has been changing over the last several decades. The increasing role of the State, particularly in regard to cyclical fluctuations, external aggressions and developmental expenditure, has emphasized the significance of deficit financing. The management of deficit financing being a very complicated affair requires very careful tackling. Because of the stupendous importance of the problem in recent times, it is necessary to be very clear about the concept and the mechanism by which deficit financing affects the national economy.

Concept, Meaning, and Mechanism

Undoubtedly, deficit financing is a complex fiscal operation. It is an operation which people dread, but the government cannot function without it. Many problems in this regard arise due to the difficulty in identifying the stage when a simple banking operation becomes deficit financing. No one expects the receipts and the expenditures of any organization, whether public or private, to balance all the time, under every circumstances. Gap between the two is inevitable and in due course every organiza-

tion would try to balance the two sides. But, this simple transaction on behalf of the government has acquired such an esoteric significance that the uninitiated ones find it difficult to understand. This complexity has arisen because of the indeterminateness between natural imbalance and deficit financing. When does over-spending become deficit financing? According to changing requirements of time, the meaning of deficit financing has also been changing.

A budget, until recently, used to be considered surplus or deficit depending upon its being so on revenue account. This concept has, however, lost much of its justification. Presently, public borrowings and capital expenditure have gained importance. The government budgets have now become an important device for enforcing its economic policy. For such a consideration, both the revenue and the capital budgets are considered together; any categorization in this context based on earlier classifications would be meaningless. Budgetary heads, therefore, must have economic classifications. For this purpose, several groupings have been suggested. First, it must show the distinction between investment and consumption expenditures. The former relates to the creation of physical assets and the latter to the expenditure on goods, and on payments of wages for providing various services such as defence, administration, education, and so on. Another way of classifying the budget relates to development and non-development expenditures. The decision regarding putting any specific item under development head is indeed involved, nonetheless, generally speaking, those items of expenditure which are directly designed to promote economic development and social welfare activities may be considered developmental. These classifications are not comparable because they are based on entirely different principles.

Development and non-development expenditures cut across the former classification between investment and consumption. Development expenditure may include both current expenditure as well as capital formation. The strategy of planning for

accelerating the tempo of industrialization has led to another classification of plan and non-plan expenditure. The former refers to all expenditures on schemes and projects provided under the plan and the rest is put as non-plan expenditure. Obviously, the total expenditure on plan is not necessarily developmental; similarly all non-plan items may not be non-developmental. Such elaborate classifications based on different criteria would clearly indicate the confusion and futility of the revenue and the capital account classifications. The contemporary trend in budgetary accounting suggests the need for evolving more scientific and meaningful classification of the budget.

The central core of deficit financing is connected with the mechanism by which the deficit in expenditure is covered and with the items for which deficit in expenditure was incurred. In earlier definitions when deficit financing referred to the gap between receipts and disbursements on revenue account, public borrowings were not included on the receipt side, but the proceeds of public loans utilized for bridging the gap were considered as deficit spending or deficit financing. In modern times, however, borrowings from the public are included on the capital side, and the various methods of bridging the gap are taken into account for measuring the magnitude of deficit financing. In other words, the volume of deficit financing is now measured in terms of an overall budget deficit, which means the aggregate of the deficit on both the revenue and the capital accounts.

But, in order to make this concept even more meaningful, it may be necessary to relate the operation of public spending with the different types of responsibilities assumed by the government. Public receipts may be classified under six heads, namely, (i) taxes on economic activities, such as taxes on personal and corporate earnings, taxes on transfers of income, taxes on economic transactions, etc., (ii) fees for the services rendered, such as fare from the railways, postal charges, education fees, etc., (iii) earnings from banking services rendered by the government as for example, receipts from the contribution to provident fund, life insurance company, annuity deposits, postal savings

schemes, etc., (iv) public borrowings, (v) deficit financing, and (vi) miscellaneous receipts. This is another unorthodox classification but this kind of classification might clarify many politico-economic issues involved in the functioning of the State. This classification could enable assessment of the profitability of the State activities; it may also demonstrate the desirability or otherwise of the State taking up a large number of public undertakings at exorbitant social cost. The classification suggested above does not need any special effort excepting that the available information should be reorganized. This classification could indicate how much avoidable functions have been undertaken by the State in the interest of the society for achieving certain welfare objectives. In case of financial difficulties, this classification could help shedding off of non-essential functions.

During recent years, the public sector activities have grown bigger. In earlier times, the State undertook only certain special types of work. Post and telegraph, railways, electricity, and water supply were considered such economic activities. These operations were justified due to special characteristics of these enterprises. Under the expanding scope of economic development, many other activities have also been included. The Industrial Policy Resolution of India has even defined the spheres of industrial activities which would be the exclusive charge of the government. There have been some activities in which the public as well as the private sectors could start enterprises. The State's entry into business activities having primarily commercial end in view, as distinguished from the objective of maintaining law and order, should not be exonerated from price-cost discipline. The State should not be precluded from receiving pecuniary advantages from its undertakings either. When receipts and expenditures for such enterprises are consolidated together, the taxpayers might examine the efficacy of such enterprises. It would also demonstrate clearly whether the State has been able to run them in business-like manner. Most of the activities included under this category should pay for themselves. Deficit financ-

ing or such abnormal ways of raising financial resources should be resorted to only for meeting abnormal emergency expenditures specially arising out of law and order situation including foreign aggression.

Certain operations of the banking nature are also undertaken by the State. Contributions towards provident fund, annuity deposits, savings bank deposits, and current banking deposits do not differ in kind but only in degrees. Moreover, there are different kinds of financial institutions with varying degrees of credit-worthiness. So the distinction between the State, Central, Scheduled, and non-Scheduled banks for such banking transactions need not be considered different in kind. As the State has a dual personality of an economic entity as well as that of the agency charged with the responsibility of ensuring social welfare (including maintenance of law and order), the public borrowings could be viewed as a kind of financial transaction by which the economic State borrows money from the public for the use of the welfare State. Thus, there may be even a justification for lumping together the receipts from public undertakings, banking transactions, and public borrowings. An important feature of such transactions would be that the citizens would be treated as customers willing to take advantage of the services provided by the State.

Deficit financing in this scheme of classification assumes a different and limited role. It arises due to over spending of the State. It is not related to the special purpose for which the amount is raised. This imbalance arises either due to the inability of the State to mobilize voluntary contributions from the public for specific activities as in the case of war or due to the reluctance of the tax payers in general to add to the public coffer. In fact, the inability of the State as well as the unwillingness of the people both taken together characterize the psychological setting for deficit financing. Moreover, such overspending represents a sort of public "loss." When a company is unable to carry out its transactions on the basis of its current earnings, and has to draw upon its contingency fund,

or sell some of its capital stock, the company is said to be running at a loss. On a similar analogy, when the State is unable to meet its current expenditure from its normal receipts and has to draw upon deficit financing, it may be said to be having "loss." The special feature of this type of financing arises from the fact that this operation is the special prerogative of the sovereign body whose decisions rule supreme, and which cannot be overruled by any other agency.

The technique of overcoming the budgetary gap is simple. It implies withdrawals from the cash balances or borrowings from the Central Bank, or the both. Such apparently simple devices have, however, many delicate and intricate adjustments. When the government decides upon raising funds from deficit financing with the help of banking authorities it sells its securities to the Central Bank on the basis of which the latter issues paper currency by resorting to the (government) printing press. Dangerous chain reactions are initiated with this operation. The aggregate money supply expands without corresponding increases in national wealth. Cost-price-wage-cost spiral raises the prices to soaring heights. It weakens the economy, complicates the industrial organization and disrupts the social structure. Simply stated, deficit financing means that the government has spent more money than it has received, but the resulting consequences of this operation are appalling. The people are not so much concerned with the budgetary operations and adjustments, to which in fact every individual, family and industrial organization sometimes or the other adhere to without threatening their well-being. But they are very much concerned with the implications of deficit financing because if carried to dangerous limits it might even completely destroy the beneficial effects of the operation. In this way, the very purpose for which deficit financing is undertaken may be frustrated. The people are, therefore, not so much afraid of deficit financing as of its consequences.

Consequences of deficit financing depend upon the whole gamut of economic forces which conspire the government to resort

to this method of resource mobilization. The primary effect of this operation is to reinforce effective demand in the community. During an emergency, it aims at quickening the speed of resource mobilization. In either case, deficit financing necessitates a careful analysis of the various supporting conditions in order to assess and regulate its impact.

Consequences of Deficit Financing

The worst impact of deficit financing is not so much economic as administrative. The fact that the unilateral decision of the government has been responsible for deficit financing without taking the issue to the tax-payers presents a very delicate situation verging on economic, political, and social impropriety. For raising the postage, sales tax or income tax, the sanction of Parliament has been essential, but the decision regarding increasing the level of deficit financing is purely administrative. The essence of this behaviour lies in the fact that the government has embarked, whether willingly or unwillingly, upon a programme of expenditure which is not commensurate with the resources available to it. Such an action can be taken by the government without any control from any higher authority (such as Parliament). Therefore, it has an element of autocracy in it: it violates the tenets of democracy. Furthermore, a large amount of expenditure resources placed at the disposal of the government, while accepting the fact that the government is not an abstract entity because it also consists of human individuals with their natural family, cultural, regional, and religious proclivities would naturally suggest that the amount would be wastefully spent. If an individual can obtain easy money, he is likely to spend it without much care.

Economically, it is the increased supply of money caused by excessive issue of paper notes which is said to be the central villain. But, this factor gets complicated by the liquidity preference of the people, credit policies of banking institutions, degree of monetization, mobility of the factors of production,

volume of production and turnover of the economic goods, structure of expenditure of different classes of the people and the repercussions of the balance of payments position. From this, one may infer that the importance of money is for what it does, and in every community it does much. Its direct influence is on the price level which affects almost every sector of the economy. The inflationary repercussions on price level can however be modified by the presence of increased quantum of consumer goods, credit restrictions, and larger payments for the adverse balance of payments. Increased productivity as a result of capital intensification, and greater availability of consumer goods would mitigate the inflationary pressure. In short, when increased supply of money is counter-balanced by larger availability of articles of consumption, the adverse consequences of deficit financing are considerably avoided. Physical control, regulated distribution to industrial raw materials, and rationing of consumer articles are merely palliatives which are bound to fail in acute cases and in the long run.

The transfer of income resulting from deficit financing distorts the social consumption pattern. When the purchasing power of the earnings of the individual declines due to the increasing volume of money supply, the salaried class such as the government servants, teachers, professors, and pensioners who mostly represent the intelligentsia of the community, is severely hit both financially and socially. Their earnings, that is their salaries, are sticky; they find it hard even meeting the essential daily needs. The non-salaried class, on the other hand, has large expansions in their accounted and unaccounted money. The entrepreneurs, businessmen, doctors, lawyers, contractors, piece-rate workers, and the like receive much increased money income. Essential items of consumption being limited, there is diversion of demand towards those non-essential items which are available, notwithstanding their exorbitant prices. If the situation persists over a long period, the industrial organization itself might be adapted to meet such demands, and urgent social requirements would be neglected. Changes in social structure

resulting from the emergence of *nouveau riche* create dissatisfaction, and among the morally immature individuals it breeds corruption, greed, ambition, and, therefore, social degeneration.

Under artificial conditions created by massive deficit spending, the investment pattern is distorted because private investors are guided by monetary reward in contradistinction with the objective of real social requirements. The large amount of monetary profit available to businessmen, industrialists, and others induces them to invest it rapidly in whatever avenues it could be assured higher returns; and as a matter of fact, a large variety of non-essential items are produced with such investments. The large varieties of products on which money could be spent need not necessarily be socially the most desirable channels of expenditure. A large number of business activities therefore grow up in order to satisfy the immediate demand of non-salaried but moneyed business class, which explains mushroom growth of casinos, night clubs, restaurants, picture houses and similar other places of recreation during the period of such uncertainties. Psychologically also, people become more individualistic, self-centred, and hedonistic which are reflected in moral degeneration of the people.

The shrinkage of the horizon of expectations even affects the industrial development of the country very adversely. Not believing in the establishment of stable market conditions in near future, the investment schedule is adjusted in such a way that greater emphasis is laid on building the stock at the early stages of production process, rather than in augmenting the final output. The industrialists are more interested in building inventories rather than in selling the products. Consequently, one finds that the quantum of finished products is drastically reduced in the market, the inducement to accelerate production diminishes, the desire for holding stocks at every stage becomes pronounced, and the industrialists are more concerned with building capacity rather than with actual production and marketing. These conditions encourage hoarding, black-marketing, and profiteering.

Under these conditions, even the cost structure of industrial production gets upset. The rising prices of consumer goods induce the wage earners to demand higher wage rates. The government is also forced to grant increased dearness allowances. Simultaneously, rents, retail consumer prices, and the cost of household services go up. Increases in industrial prices accentuating price differentials between industrial and agricultural commodities force the government to step in to provide guaranteed prices to agriculturists. The spiral never goes down-swing. The economy is over-heated. There is constant cost-price push raising the price spiral higher and higher. There is no stability in such an economy.

Balance of payments also deteriorates under inflationary pressure. Imports of consumption goods could have reduced the intensity of inflation but the restrictions necessitated by decline in export performances arising mainly due to the disparity between domestic and international prices, do not allow imports to increase. The need for larger imports, however, goes on increasing: the developmental activities require larger imports of capital equipment and rationalization (and economy) in the use of scarce foreign exchange. When such distortions take place, the government has to impose greater amount of import control measures and rationing of foreign exchanges. Unfair practices, smuggling, and other anti-social activities create further difficulties for the country.

In short, inflation caused by unmitigated deficit financing creates abnormal conditions. An important casualty under such circumstances is law and order. When there is no faith in the monetary unit of the government, industrial organization is in flux, class structure is disturbed and the future holds no charm, then it is natural to expect deterioration in law and order. But, maintenance of law and order being the sole responsibility of the government, larger expenditure on this head becomes necessary. In order to check smuggling, black-marketing, and infringements of foreign exchange regulations, reinforcements of various departments are necessary. But,

the maintenance of industrial peace poses a more difficult problem. Other anti-social activities such as murder, burglary, theft, etc., require special police arrangements. More expenditure at a time when taxation has already reached a high level, and the people are crushed with its burden, would only imply larger deficit financing. Thus, the vicious circle is complete. Deficit spending would lead to greater deficit financing, and the honest income earners would go on groaning a little louder.

Deficit Financing and Indian Planning

Deficit financing in India had increased substantially during the recent years. As it would be seen from the table given below, from a surplus of Rs 11.7 crores in 1950-51, the overall

TABLE I
BUDGETARY DEFICIT OF THE CENTRE
AND THE STATES

(Rs. Crore)

Year	Total Outlay	Deficit
1950-51	898.47	(—) 11.71
1951-52	1,050.23	2.08
1952-53	953.06	44.49
1953-54	996.26	36.07
1954-55	1,214.62	93.96
1955-56	1,424.81	155.05
1956-57	1,651.18	253.51
1957-58	2,018.45	497.42
1958-59	2,138.76	140.00
1959-60	2,418.97	112.00
1960-61	2,660.27	(—) 60.54
1961-62	2,868.15	87.58
1962-63	3,580.22	131.99
1963-64	4,030.27	173.30
1964-65	4,803.74	152.15
1965-66	5,479.54	334.00
1966-67 (R.E.)	6,491.84	271.03
1967-68 (B.E.)	6,320.46	101.85

SOURCE: Union and State Budgets.

budgetary deficit of Centre, States, and Union Territories increased to Rs 155 crores in 1955-56; in 1960-61, there was again a surplus of Rs 60.5 crores but by 1965-66, the deficit rose to Rs 334 crores. Combined total outlay of the Centre, States, and Union Territories has increased more than sevenfold since 1950-51. The outlay which amounted to Rs 898.5 crores in 1950-51 increased to Rs 1,050.2 crores in 1951-52, Rs 1,424.8 crores in 1955-56, Rs 2,018.5 crores in 1957-58, Rs 2,660.3 crores in 1960-61, Rs 5,479.5 crores in 1965-66, Rs 6,320.5 crores in 1967-68 (B. E.).

Increases in developmental expenditure have been pronounced during recent years: it increased from Rs 353.7 crores in 1950-51 to Rs 710.3 crores in 1955-56, Rs 1,234.7 crores in 1960-61, Rs 1,414 crores in 1961-62, Rs 1,669.6 crores in 1962-63, Rs 1,872.8 crores in 1963-64, Rs 2,109.9 crores in 1964-65, Rs 2,301.4 crores in 1965-66, Rs 2,462.1 crores in 1966-67 (R. E.), and Rs 2,695.7 crores in 1967-68 (B. E.). But the proportion of developmental expenditure to the total outlays of the government has been fluctuating. In 1950-51, this item accounted for 39.3 per cent of the total outlay, and in 1955-56, it increased to 49.8 per cent. Since then, its trend has been downward, amounting to only 46.4 per cent in 1960-61, but in 1961-62 it increased to 49.3 per cent, but it again fell to 46.6 per cent in 1962-63, 46.4 per cent in 1963-64, 43.9 per cent in 1964-65, 42.0 per cent in 1965-66, and 37.9 per cent in 1966-67 (R. E.). In 1967-68, it is estimated that this proportion may be of the order of 42.6 per cent.

From the above, one may infer that the non-developmental expenditure of government—Centre and States combined—has increased significantly. In 1950-51, it amounted to 60.7 per cent of the total outlay; in 1955-56 the proportion had declined to 50.2 per cent but by 1966-67 the proportion increased to 62.1 per cent. A closer examination of the expenditure over general administration excluding defence, but including external affairs police, justice, and jail, as would be evident from Table 2, would show substantial increases from Rs 117.16 crores in 1950-51 to

ing to deficit financing which have become louder during the last three plan periods would however in the present context be restricted. The overall budgetary deficits have remarkable impact on the economy as a whole, but the plan deficits indicate the burden of the plan outlay on the national economy, and the planners were therefore very much concerned about deficit financing from the very beginning of the First Five Year Plan.

During the initial stages of planning, the adverse repercussions of deficit financing were almost absent. Though in 1951-52, substantial food imports had become essential and by that time, developmental outlays had gained momentum, yet deficit financing was under control. Even then, the First Plan approached the problem with caution and care. It was recognized that the significance of plan deficit should be assessed in relation to overall budgetary deficit. The First Plan indicated that the "term 'deficit financing' is used to denote the direct addition to gross national expenditure through budget deficits, whether the deficits are on revenue or on capital account. The essence of such a policy lies therefore in government spending in excess of the revenue it receives in the shape of taxes, earnings of State enterprises, loans from the public, deposits and funds and other miscellaneous sources. The government may cover the deficit either by running down its accumulated balances or by borrowing from the banking system (mainly from the central bank of the country and thus 'creating' money)."¹

This clearly shows that the First Five Year Plan considered the financing pattern in relation to the overall condition of the economy. It realized that the inflationary potential of the First Plan was limited due to the favourable condition prevailing in the country, nonetheless it emphasized the necessity of a close watch on it. It was stressed that deficit financing could succeed only under certain specific conditions. The First Plan Report stressed that "deficit financing can be countenanced only if and to the extent that

¹*First Five Year Plan*, Planning Commission, New Delhi, pp. 59-60.

there is assurance of steady supplies of the essential commodities of consumption.”²

Deepening Complexity of Deficit Financing

During the course of the formulation of the Second Five Year Plan, the question of deficit financing was given serious and detailed consideration. Prior to the final decision relating to the magnitude of the Second Plan and the scheme of its financing, the Panel of the Economists set up by the Planning Commission and consisting of eminent Economists of the country, considered the Tentative Framework of the Second Five Year Plan. An increase in national income of about 5 per cent every year during the Second Plan period was by no means considered unrealistic or ambitious. For this purpose, the total amount of net investment was expected to be of the order of Rs 5,600 crores: Rs 3,400 crores in the public sector and Rs 2,200 in the private sector. The Tentative Framework envisaged a total outlay of Rs 4,300 crores in the public sector. During the five years of the Second Plan, the total government expenditure was estimated at Rs 8,800 crores.

The available resources were estimated at Rs 6,400 crores, Rs 5,200 crores accounting for receipts on revenue account, Rs 200 crores from railways and Rs 1,000 crores as loans from the public. This resulted into an anticipated gap or deficit of Rs 2,400 crores. External assistance to the public sector was expected to be around Rs 400 crores. The Tentative Framework indicated the inability of filling the entire gap of Rs 2,000 crores by deficit financing, and suggested that the deficit financing by the government must be restricted to Rs 1,000 to Rs 1,200 crores. This scheme of financing the plan was drawn under the assumption that “deficit financing as a means of drawing unutilized resources into the system is justifiable. Continued reliance on it may, however, distort the price structure and create instability.”³

²*Ibid.*, p. 61.

³*The Second Five Year Plan: A Tentative Framework*, Planning Commission, New Delhi, p. ii.

The Panel of Economists did not consider deficit financing as "necessarily always dangerous." "It is the timing and magnitude of deficit financing that is of crucial importance."⁴ The panel, however, suggested that continued dependence on this device had to be avoided and any emergence of inflationary pressure in the economy watched and checked. "Any indication that inflationary pressures are developing must be met by timely and suitable action to keep it under check,"⁵ it stated. In view of the expected increase in production and the rising level of national income, the Panel suggested that "for a year or two deficit financing at a rate of Rs 200 crores or so is safe and even necessary."⁶ But it cautioned: "On the whole, we do not recommend deficit financing of a larger extent than that indicated by the figure of Rs 1,000 crores for five years and are of opinion that the situation in this regard should be kept under watch and should in any case be re-examined at the end of the second year or at the midpoint of the plan period."⁷ Thus, while approving deficit financing of about Rs 200 crores for the first few years of the Second Plan, the Panel of Economists reiterated the pitfalls and dangers of deficit financing and urged that it should at the earliest be reduced to a manageable size.

Professor B. R. Shenoy of the Gujarat University and an important member of the Panel of Economists, however, disagreed with his colleagues and apprehended serious danger for the economy even for this order of deficit financing. The shortage of real resources could not be mitigated by deficit financing. "Deficit financing does not create real resources."⁸ There were certain circumstances when this method of resource mobilization could be useful, but the underdeveloped countries in general, and the contemporary Indian economy in particular did not offer such conditions.

⁴*The Second Five Year Plan: Some Basic Considerations*, Planning Commission, New Delhi, p. 4.

⁵*Ibid.*, pp. 4-5.

⁶*Ibid.*, p. 4.

⁷*Ibid.*, p. 5.

⁸B.R. Shenoy, *Note of Dissent to the Memorandum on the Second Five Year Plan*, Planning Commission, New Delhi, p. 7.

The continued below the demographic rate of saving and investment in underdeveloped economies, as against the rate of savings being generally above the demographic rate, as in the industrialized countries makes the underdeveloped countries unresponsive to deficit financing. In industrial economies, according to Professor Shenoy, "unemployment of labour was accompanied by unemployment or underutilization of the complementary real resources of production" which could be bridged by credit creation.⁹ Deficit financing or credit creation here is a device of mobilizing the real resources.¹⁰

Therefore, Professor Shenoy indicated that underemployment in underdeveloped economies, thus, offered no criterion for deficit financing in the way unemployment in the industrial economies offered such criterion.¹¹

While disagreeing with the amount of deficit financing to be about Rs 1,000 crores as recommended by the Panel of Economists, Professor Shenoy emphasized that the amount of the deficit financing and the amount of the credit creation should be together limited to the *increase* in the cash balance. Based on the availability of Sterling releases during the five years as between Rs 100-Rs 150 crores, and the credit creation by the banking system as around Rs 35 crores per annum and a division of the cash balance resources and the Sterling releases between the public and the private sectors respectively in the ratio of 2:1, the order of magnitude of the aggregate deficit financing according to Professor Shenoy, could be Rs 180—220 crores for the five years, or an annual rate of Rs 35-44 crores. Even on the assumption of a doubling of the rate of growth of the national income, the demand for the additional cash balances cannot be of an order to justify deficit financing on a scale equivalent to 50-60 per cent of the money supply. Based on these considerations, Shenoy thought the Panel recommendation as "far too excessive."

It is, however, significant that Professor Shenoy conceded that

⁹*Ibid.*, p. 6.

¹⁰*Ibid.*

¹¹*Ibid.*

"deficit financing is essential in an underdeveloped economy to permit full use of the scarce real resources"¹² but he urged that the "deficit financing should stop severely short of the point at which inflation begins." He was greatly opposed to inflationary potential of deficit financing because inflation did not add to the aggregate real resources. He further stated that

It creates wasteful or socially less useful demands on the limited savings. Investment gets distorted into luxury trades to meet the demand for their products resulting from inflation incomes. It diverts an undue proportion of savings into urban property and real estate, into gold hoards and jewellery, and into foreign exchange, as a result of the effort of savers to protect the value of their savings. The resources available for the Plan would be, as a result, correspondingly less, and overall economic development would be impeded. Inflation tends to be self-perpetuating. With the rise in prices and wages, the original estimates of the cost of the project taken in hand will be out of date. More deficit financing would be necessary for their completion. And as they cannot be left half-finished, there would be pressure for further deficit financing.¹³

Second Plan and Deficit Financing

Despite the cautionary note of Professor Shenoy and others, the Second Five Year Plan began with enthusiasm and expansionary tendencies. For a plan of Rs 4,800 crores, the anticipated domestic resources amounted to only Rs 2,400 crores, and the rest, that is half of the plan outlay during the Second Plan period was expected to be met from external assistance (Rs 800 crores), deficit financing (Rs 1,200 crores) of which Rs 200 crores accounted for Sterling releases and a gap of Rs 400 crores was left uncovered. The anticipated budgetary resources of the Central and the State Governments were estimated at Rs 2,400

¹²*Ibid.*, p. 8.

¹³*Ibid.*, pp. 8-9.

crores, of which Rs 800 crores was expected from surplus from current revenues, Rs 1,200 crores from the public borrowings, and Rs 400 crores from the Railways, Provident Funds, and other accounts. This scheme of financing was acknowledged to weigh heavily on domestic resources but the magnitude of the task assumed during the Second Plan period was also colossal.

The experience gained during the First Plan period was favourable. The inflationary pressure on the economy was practically controlled; in fact, there was some apprehension of recession, specially during the period following the Korean War. The Sterling balance was also sizeable. Therefore, the Planning Commission was emboldened to launch a plan with a provision of deficit financing of the order of Rs 1,200 crores. Nonetheless, it was realized that "the expansion of money supply of the order mentioned cannot but be regarded as the outside limit."¹⁴

The course of the Second Plan did not run smooth. There occurred the foreign exchange crisis, which necessitated several adjustments and readjustments. The public gaze was fixed on external assistance and on the urgency of obtaining substantial amount of foreign aid rather than on mobilizing domestic resources. During the Second Plan period, Rs 2531.14 crores of external assistance was authorized; even utilization of foreign aid during the period amounted to Rs 1430.19 crores.

Deficit financing during the Second Plan period amounted to more than the anticipated level. As against Rs 1,000 crores of deficit for a plan of Rs 4,800 crores, the latest estimates show that deficit financing reached the level of Rs 954 crores for a plan outlay of Rs 4,672 crores. The estimates of actual deficit financing has been variously estimated by different authors. Dr Kulkarni¹⁵ has indicated that the estimates ranged from Rs 948 crores to Rs 1,483 crores.¹⁶ Whatever the level of

¹⁴*Second Five Year Plan*, Planning Commission, New Delhi, p. 84.

¹⁵R.G. Kulkarni, *Deficit Financing and Economic Development*, Asia, Bombay, pp. 261-4.

¹⁶B. R. Shenoy, "Era of Deficit Budgets," *Times of India*, Bombay, 28 February 1961.

deficit financing, there may not be any objection to agreeing with the conclusion of Dr Kulkarni

that judged by any standard or criterion, the extent of deficit financing during this period has clearly been excessive and has certainly strained the economy. It is true that the upper limit of Rs 1,200 crores for the entire plan period was not crossed. However, taking into account the reduction of the total public sector outlay from Rs 4,800 crores to Rs 4,600 crores the actual volume of deficit financing should have been much less than originally contemplated.¹⁷

The impact of deficit financing has been drastic. We have shown in an earlier chapter that the prices during the Second Plan period rose by more than 30 per cent and the cost of living by more than 24 per cent. It is true that the deteriorating price situation and the rising inflationary spiral had not by the end of the Second Plan period completely disrupted the economy, but the economists, however, had begun seeing symptoms of the weakening of the structure. Dr Kulkarni, himself an ardent supporter of deficit financing as having a place in the developmental efforts provided it was managed carefully, has bitterly concluded that "the policy of deficit financing during the Second Plan period failed because the initial safe upper limit of deficit financing was not properly worked out; the volume of deficit financing was not related to any specific criterion, but was undertaken in a sporadic fashion; no attention was paid to the cost and price considerations with reference to which the quantum of deficit financing should have been calculated; large buffer stocks of foodgrains, and other basic needs of life were not accumulated; utmost efforts to raise budgetary resources (particularly by the States) and thus to mop up the additional income created by inflationary devices were also lacking in the implementation of this policy."¹⁸ Dr Kulkarni has gone to the extent of mentioning that

¹⁷R. G. Kulkarni, *op. cit.*, p. 329.

¹⁸*Ibid.*, pp. 533-4.

... it is beyond doubt that the programme of deficit financing during the Second Plan period, although it might have assisted in the attainment of financial targets and to the development in the economy to that extent, created instability. The inflationary pressure generated during this period has certainly hit hard the large sections of the population, and judged from their point of view, it is doubtful whether there has been any development at all, with such attendant sufferings. The official reactions to the emergence of inflationary situation are of a happy-go-lucky nature.¹⁹

The Economy Crumbles

The real difficulty occurred during the Third Five Year Plan. The need for a large plan was imminent. The total outlay during the Third Plan was envisaged at Rs 7,500 crores. The scheme for financing it made a very cautious approach to deficit financing. The rising trend in market prices and depleted foreign exchange reserves made it necessary that the deficit financing was limited to the minimum warranted by genuine monetary needs of the economy.

Considering the economic conditions prevailing at the beginning of the Third Plan period, the limit of deficit financing during the Third Plan period was placed at Rs 550 crores, exclusive of the direct extension of credit by the Reserve Bank to co-operative agencies. It was, however, stipulated that the amount of deficit financing to be undertaken would be adjudged from year to year in the light of emerging economic trends. "Deficit financing within moderate limits," according to the Third Plan Report, "has a place in developmental planning but if it adds to the purchasing power unduly at the time when the need is to keep it down so as to restrict consumption within the limits provided for the Plan, the consequences to the economy can be highly deleterious."²⁰

¹⁹*Ibid.*, p. 533.

²⁰*Third Five Year Plan*, Planning Commission, New Delhi, p. 100.

In order to avoid such difficulties, the Third Plan hoped that the device of deficit financing would be resorted to only in exceptional circumstances. The situation, however, soon deteriorated. The Chinese aggression in 1962, the Pakistani invasion in 1965, and the food shortages during the following years created abnormal conditions. Because of the inevitable role of deficit financing during emergency, the limit of deficit financing envisaged in the Third Plan Report was soon transgressed and by the end of the Third Plan period, the Plan outlay of Rs 8,631 crores (as against the original Rs 7,500 crores) had to be financed by Rs 1,150 crores of deficit financing as against the original target of Rs 550 crores. The impact of this amount of deficit financing along with colossal expansion of defence and other non-plan expenditure can easily be imagined. During the last three years of the Third Plan, the general price index rose by a measure larger than the increase that had occurred during the preceding ten years.

Determination to Eschew Deficit Financing

The original Fourth Five Year Plan as envisaged in August 1966 had no place for deficit financing. For a total outlay of Rs 16,000 crores in the public sector, it was envisaged that there would be no resort to deficit financing. In order to ensure that any excessive purchasing power in the economy did not lead to distortions in the Plan, a variety of monetary and fiscal measures were anticipated. "Deficit financing will have to be avoided."²¹ Self-reliance has been considered the main task of the Fourth Plan.

Resource mobilization is in some ways the kingpin of the Fourth Plan. This is so because for the first time, the Indian plan of economic development has assumed complete eschewal of deficit financing. Deficit financing not only emerges from budgetary deficits but can also arise in many other ways, including credit creations. It is, therefore, imperative that a

²¹A Draft Outline of the Fourth Five Year Plan, Planning Commission, New Delhi, p. 16.

close watch is kept on all avenues of deficit financing and prompt action taken.²²

While discussing the question of resource mobilization, the Draft Outline stressed that the substantial increase in the budgetary deficits in 1965-66, higher domestic prices, devaluation and continuing imbalance between imports and exports, made it more important than ever that financing should be on a completely non-inflationary basis.²³

These notes of warning have been difficult to follow. During the course of the three Annual Plans beginning with 1966-67, the size of deficit financing has been substantial. It was estimated that deficit financing in 1966-67 would be only of the order of Rs 12 crores: the central government would have an overall deficit of about Rs 25 crores, and the Governments of Madhya Pradesh, Mysore, and Rajasthan would have a total surplus of Rs 13 crores in order to reduce their outstanding overdrafts with the Reserve Bank. The total outlay for the 1966-67 Plan was estimated at Rs 2,081 crores. If achieved, this level of deficit financing could have very much improved the situation. In actual implementation, the size of the Plan outlay increased to Rs 2,221 crores and the size of the deficit financing increased to Rs 340 crores. This imposed further strain on the economy.

Strenuous efforts to restrain the inflationary impact of budgetary operations were necessary. Despite the cautious note, and providing only Rs 14 crores as deficit for an Annual Plan of Rs 2,192 crores for the year 1967-68, the actual deficit for the year amounted to Rs 318 crores. Obviously, the urgency of avoiding deficit financing as laid down in the Draft Outline has not as yet been fully realized. Like a drunkard always promising to abstain but every time falling prey to temptation, the determination to "eschew" deficit financing is made but on every temptation the sacrifice is postponed. Thus strain on the economy has been continually increasing for the last fifteen years.

²²*Ibid.*, p. 32.

²³*Ibid.*, p. 75.

Final Assessment

Deficit financing as a means for mobilizing domestic resources has a legitimate place in the national economy. But, if it is used in an unrestricted manner it might do much harm. Professor Shenoy has considered it "the best subsidy to communism." Dr Gyanchand has argued it as "a real evil and it is absolutely essential that it should be avoided in all its forms."²⁴ B. K. Madan of the Reserve Bank of India has stated that "excessive deficit financing implies the abandonment of planning in regard to the financing of development since the distribution of incidence of the cost of development does not conform to a considered and rational plan of meeting the costs, but follows the line of least resistance and thereby invites consequences that might run counter to the Plan objectives and distort and disrupt the orderly course of development."²⁵ T. T. Krishnamachari accepted deficit financing as a "medicine, to be taken in small doses ; it is not food that could sustain the system."²⁶ Evidently, the dangerous consequences of deficit financing must be recognized and judiciously used.

In India, deficit financing has been increasingly used to meet the growing expenditure of the government. The advent of planning involving colossal outlays has intensified the difficulty. During the First Plan period, its impact has not been severe, but the inflationary pressure and its consequential distortions have increased significantly since the beginning of the Second Five Year Plan. During the Fourth Five year Plan, deficit financing is contemplated to be completely eschewed but the past few Annual Plans do not show any reversal of the trend. Dr Kulkarni has considered it as loss of an opportunity for exercising effective management of deficit financing for developmental financing. Necessary precautions and safeguards, which must go

²⁴Gyanchand, *The Menace of Inflation*, Manaktalas, Bombay, p. vi.

²⁵B. K. Madan, *Aspects of Economic Development and Policy*, Allied, Bombay, 1964, p. 10

²⁶T. T. Krishnamachari, *Deficit Financing*, Reserve Bank of India Bulletin, June 1957.

with this policy were not taken, so that deficit financing instead of contributing to development efforts, created new problems.²⁷ In this connection, Dr Kulkarni has further stated that the "inflationary pressures resulting from deficit financing were aggravated due to a considerable increase in non-development expenditure."²⁸

In determining the repercussions of deficit financing, a gamut of factors has to be examined. If administrative expenditure cannot be judiciously economized, if defence outlays cannot be reduced due to the manoeuvres of neighbouring countries, if the utility services cannot recover their own servicing costs, if large-scale subsidies characterize economic and industrial policies of the country, if the commercial undertakings of the public sector fail to earn profits, if productivity and efficiency in industrial enterprises are awfully low and if there has been persistent strain on balance of payments, then it is futile to consider deficit financing as the only cause of anxiety during the course of developmental activities. It is not the gap in resources which is disturbing, rather it is proliferation of the administrative structure, multiplication of inefficient enterprises, and the expansion of nonproductive channels of expenditure which have created the difficulties. With improvements in administration, production and mass-behaviour, deficit financing can be a useful source of financing developmental activities.

The scope of its activities, however, should be very limited. Generally speaking, it should be considered politically unjustified because it puts at the disposal of the ruling party enormous power to use the resources of the country in any way it desires. It is economically dangerous because it destroys legitimate incentive for production, leads to inequality of income and creates instability in the economy. Ethically, it is ruinous because it disrupts the society and the social obligations, and puts premium on black marketing and unfair market practices.

²⁷R. G. Kulkarni, *op. cit* , p. 330.

²⁸*Ibid.*, p. 331.

Deficit financing breaks the morale of the middle class fixed income earners and thereby weakens the progressive forces of the society. The need for keeping deficit financing under check is great and every government should resort to it only in emergency.

CHAPTER III

DEVALUATION

DESPITE FAR-REACHING consequences of devaluation, there is nothing esoteric about this simple device of reducing the external value of a national currency. In many cases, it is merely an outcome of excessive deficit financing carried out over a number of years without correcting the fundamental distortions of the economy. The case for devaluation becomes acute when the flow of external assistance begins drying up without having activated the appropriate level of exports necessary to pay for her increasing developmental and maintenance imports. The success of this measure, however, depends upon the presence of many countervailing conditions. There is often great resistance against any move towards devaluation. The proposal has political overtones as well as deeply disturbing economic consequences. Devaluation is, indeed, a dangerous recipe to be applied only in the last resort.

During the last two decades, many countries have devalued their currencies. Even the advanced countries with long tradition of industrialization have not escaped it. The United Kingdom has devalued her currency twice during the recent years. Other countries like France, Germany, and Yugoslavia have also taken similar steps. India devalued her currency once in consonance with the United Kingdom in 1949 and at another time in 1966. In this chapter, we propose to discuss this problem of devaluation with special reference to India.

What is Devaluation?

Devaluation is a method of currency management. *Encyclopaedia of the Social Sciences* has defined it as "a series of legislative enactments by which a new legal value is assigned to a depreciated monetary unit and a new settlement is decreed

for all contracts in monetary terms.” From this definition, it is evident that devaluation is a deliberate step to stabilize the par value of a national currency to a lower level. This is done generally due to decline in the real value of the national currency. External value of a currency is determined according to Professor Gustav Cassel’s well-known Purchasing Power Parity theory. This parity is decided on the basis of the ratio of prices prevailing in the two countries.

The need for such a decision arises when the par value is significantly disturbed. For illustration, it may be assumed that a quintal of wheat has been selling for Rs 45 in India while its price in the United States is \$ 10. This gives the exchange rate between the American Dollar and the Indian Rupee as \$ 1 equal to Rs 4.50. This rate of exchange under certain conditions, however, may deviate significantly. If more than \$ 1 is offered in the open market for Rs 4.50, the latter is said to be undervalued; if less than \$1 is offered, the rupee is overvalued. If the disparity is significant and persistent it would be in the interest of the country whose national currency has fluctuated in value to set the parity right. The variation from the equilibrium rate of exchange may be corrected by a government decree. The legislative enactment by which parvalue of the overvalued currency is reduced is known as “devaluation.”

Bretton Woods Agreement

Thus, devaluation is an attempt to arrive at the equilibrium rate of exchange. Fixation of the equilibrium exchange rate is, however, a difficult process. Probably, it was for this reason that the Bretton Woods Agreement which set up the International Monetary Fund and the International Bank for Reconstruction and Settlement did not define the term “Fundamental Disequilibrium.” When the representatives of the forty-four nations met at Bretton Woods, New Hampshire towards the close of the Second World War, in July 1944, they considered the question of safeguarding all kinds of casual, speculative, and competitive devaluation. With the setting of the Inter-

national Monetary Fund, it was laid down that its objectives *inter-alia* would be "to promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation."¹ Section 5 of Article IV of the Agreement discussed the conditions under which par values of national currencies could be altered. It laid down that a member "shall not propose a change in the par value of its currency except to correct a fundamental disequilibrium."²

Correcting Fundamental Disequilibrium

Having stipulated the various restrictions imposed on the government wishing to devalue, the Agreement provided that the Fund shall concur with a proposed change "if it is satisfied that the change is necessary to correct a fundamental disequilibrium. In particular, provided it is so satisfied, it shall not object to a proposed change because of the domestic, social or political policies of the member proposing the change."³ Thus, Fundamental Disequilibrium is a major condition under which a member nation may be permitted to devalue. But, the nature and characteristics of Fundamental Disequilibrium were left undefined in the Articles of Agreement.

"From a tactical point of view," Professor Ragnar Nurkse has stated, "it may have been wise to leave the interpretation of this phrase to the managers of the Fund or to the member countries concerned in each particular case; the statutes of the Fund may not be a suitable place for the definition of so abstruse and perhaps controvertial a subject."⁴ Professor Nurkse has, however, attempted to concretize this "rather a hackneyed subject but of considerable practical importance." He has defined the equilibrium rate of exchange as "that rate

¹Norman Crump, *The A.B.C. of the Foreign Exchange*, Macmillan, London, 1963, p. 233.

²*Ibid.*, p. 243.

³*Ibid.*, p. 244.

⁴Ragnar Nurkse, "Conditions of International Monetary Equilibrium," *Essays in International Finance*, Number 4, Spring 1945, International Finance Section, Princeton University, Reprinted in *Readings in Theory of International Trade*, Blakiston Company, Philadelphia, 1949, p. 4.

which, over a certain period of time, keeps the balance of payments in equilibrium.”⁵ This apparently a very simple definition contains many phrases such as “over a certain period,” “balance of payments,” and “in equilibrium” which need elaboration. A closer examination of these terms would reveal their complicated nature.

What is Fundamental Disequilibrium ?

The unit of time over which payments should be balanced is difficult to decide. A short period like an hour, a day or a month over which this equilibrium is desired might lead, due to people’s “elasticity of expectations,” to “flight of capital, leading to further depreciation and, if the prices of commodities exported and imported also come to be affected by disequilibrating anticipations, exports will fall instead of rise and imports rise instead of fall, so that the result is still further depreciation. Such self-aggravating processes make it impossible to achieve equilibrium in the balance of payments even in very short periods such as a day or a week.”⁶

Even if we take a period long enough to overcome “seasonal” or “cyclical” fluctuations, these difficulties are not removed; it would require “some medium to settle the discrepancies arising within the standard” Longer the period, larger the amount of the medium required for settling the intervening discrepancies. The liberal provisions accorded by the Fund’s Articles of Agreement aim at avoiding the need for such a large stock of international means of payment. Apart from the fact that the country’s reserves of international means of payments, whether it is gold, foreign exchanges or international borrowing facilities, would have to vary from country to country, the finalization of the stipulated period over which the balance should be achieved is not only indeterminate but full of complicated adjustment problems.

While studying the balance of payments with a view to deciding the equilibrium rate of exchange, Professor Nurkse has

⁵*Ibid.*, p. 5.

⁶*Ibid.*, p. 6.

suggested exclusion of (i) the transfer of gold or other liquid reserves which may be necessary to balance a country's external account, and (ii) short-term capital movements either in response to temporary changes in discount rates or to movements in exchange rates within the gold points, or occurring in the form of capital flight, and "hot money" mainly due to fear of exchange depreciation or war. The primary objective of this exclusion is to eliminate all discrepancies which are due to abnormal factors.

The impact of various kinds of restrictions imposed on foreign trade should also be taken into account in order to decide the equilibrium rate of exchange. Obviously, the balance of payments is not in equilibrium if the gap arising there is closed by imposing import restrictions. A country with overvalued currency suffers a loss in its competitive power to export which necessitates import restrictions by exchange controls, import quotas, prohibitions, licences or increased import duties in order to balance the external account. Such a balance cannot be considered "in equilibrium." For this reason, Professor Nurkse has stated:

To use our definition properly, we must take the structure of trade barriers existing at a given starting-point. If subsequently a certain exchange rate can be maintained, or a balance-of-payments deficit closed, only by means of an increase in trade barriers, then the rate cannot be accepted as the equilibrium rate. The true equilibrium rate is that rate at which payments and receipts are equalized without additional restrictions on trade.⁷

The second condition that Professor Nurkse has emphasized in this context is the absence of any deliberate depression in the level of aggregate domestic money income in relation to productive capacity in order to reduce import demand. He says:

It is conceivable that a country may keep its balance of pay-
'Ibid., p. 9.

ments in equilibrium by reducing the demand for imports through a depressed level of aggregate domestic money income in relation to productive capacity; and if wage rates and prices are rigid, this contraction in money will manifest itself in large-scale unemployment in that country. The balance of payments is in equilibrium; yet it is hardly proper to call the exchange rate a true equilibrium rate if it can be maintained only by means of depression and unemployment at home.⁸

Thus, we find immense difficulties in deciding whether a country is facing Fundamental Disequilibrium necessitating any significant degree of devaluation there. As a rule of thumb, however, this term may be implied to mean, as Professor J.O.N Perkins has indicated, "a deficit that is expected to last,"⁹ but this by no means can be a guideline for any country. In fact, any decision regarding Fundamental Disequilibrium can be finalized only on a detailed study of the conditions prevailing in the country.

The Trend in Devaluation

Devaluation is a comparatively recent phenomenon. "Prior to 1914, devaluation was one of the things 'which are not done'." It was regarded as "a breach of faith both to the holders of the currency in question and also to other countries."¹⁰ But, the situation has radically changed particularly after the First World War. The Gold Standard in its various forms was seriously disturbed. The inter-war years had indeed been very troublesome. Sudden transfers of capital stock and foreign balances from one country to another brought considerable difficulties. Ultimately there was the Wall Street collapse. It destroyed the confidence in Gold Standard.

Under a gold standard system the method of attaining

⁸*Ibid.*, p. 10.

⁹J.O.N. Perkins, "Australia and the 1957 Devaluation of Sterling," *The Economic Record*, March 1968, p. 5.

¹⁰Norman Crump, *op. cit.*, p. 177.

equilibrium in international trade approximates that in domestic trade, as exchange rates as fixed within narrow limits by the fact that the various national currencies are freely exchangeable for gold at fixed legal prices... Under the free-gold standard of the nineteenth century the movement of gold from one country to another tended to correct the conditions which gave rise to it.¹¹

The self-correcting mechanism, however, could not sustain after the abandonment of Gold Standard. Though this happened in 1931, the trend towards it was apparent after 1914 itself.

Revaluation of American Dollar

Early in 1933, following the American banking crisis, the Roosevelt administration suspended the Gold Standard, and in January 1934 the dollar was formally revalued in terms of gold. The new price of gold was fixed at \$ 35 per ounce. This was equivalent to a devaluation of the dollar to 59.06 per cent of its former gold content. The international monetary situation at that time was very brittle; most of the European countries resorted to such steps several times. Many of them did so in a competitive spirit. This was done with a view to insulating their own economies from the repercussions of the monetary decisions originating in other countries.

For example, soon after the American devaluation, Belgium devalued its currency by 28 per cent. France had already been experimenting with devaluation over a number of years, but in the autumn of 1936, it devalued franc by an elastic amount ranging between 25.2 per cent and 34.2 per cent. Switzerland also simultaneously devalued her franc against gold, the amount of her devaluation being between 26 and 34.5 per cent. It was believed that the free movement of goods and services under the impact of changing rates of exchange would set any imbalance right. But, this hope was belied. And such a danger had to be safeguarded by other ways after the Second World

¹¹Kenneth E. Bouling, *Economic Analysis*, Harper, N.Y., 1955, pp. 392-3.

War. These problems were discussed in detail at Bretton Woods and the Articles of Agreement setting up the Fund and the World Bank devoted considerable thought to prevent recurrence of such movements. Restrictions were imposed on the member countries wishing to devalue their currencies. Besides assigning to the Fund the right to be consulted under such emergencies, the Fund has also a limited right to veto any devaluation of more than 10 per cent. A member country may change par value of its currency without the concurrence of the Fund if the change does not affect the international transactions of the members.

Stabilizing Influence of I.M.F.

Establishment of the International Monetary Fund has helped to a great extent achieving of the exchange stability, nonetheless, there have been occasions when many countries had to devalue their currencies. Generally speaking, as Paul Einzig has indicated, after the end of the war, the principal exchanges came to be maintained within their official "support points" fixed under the Bretton Woods system in agreement with the International Monetary Fund. Conditions became on the whole stable once more, but the frequently recurring Sterling and other currency scarcities resulted in wide fluctuations of forward rates.¹²

Even the French franc underwent serious fluctuations. The post-war vicissitudes of the Italian lira were similar to those of the French franc. Attacks on Sterling had also been a "regularly recurrent feature" of the period: in September 1949, it was devalued from \$ 4.02 to \$ 3.80. Some of the Central and the East European currencies underwent drastic depreciation. Under the inflationary pressure, the Latin American currencies had also to devalue. The Brazilian cruzeiro which was very firm at the end of the war, sharply depreciated during the fifties and the sixties. The Mexican dollar was also devalued in 1954. Even the centrally directed communist countries could not

¹²Paul Einzig, *The History of Foreign Exchange*, Macmillan, London, 1962, p. 257.

escape post-war depreciations. The rouble was repeatedly devalued, and so were the exchange rates of many satellite States.¹³

Despite such frequent alterations, the fluctuations in exchange rates following the Second World War had been more stable than those which had occurred during the period following the first. Economic knowledge and the establishment of control mechanism did much towards achieving this stability. The situation has, in fact, so much changed that the contemporary world considers devaluation under certain conditions, a powerful and effective means for accelerating the tempo of economic development.

The Mechanism of Operation

Although, strictly speaking, devaluation is a phenomenon of recent origin, it had existed earlier in different forms of currency depreciation. Many economists have, therefore, discussed the effects of the changes in the value of the national currency on its par-value. But, the problem then was not so acute, and therefore the analysis of devaluation was also not so sophisticated.

Supply and Demand Approach

When Alfred Marshall discussed the problem of changes in the general relations of international trade, he was still applying his Supply-Demand tool of analysis. He stated: "The terms of international trade can properly be said to be governed by the relations of international demand; but, with equal correctness they can be said to be governed by the relations of international supply. It seems best to speak of them as governed by international demand and supply."¹⁴ While quoting J. S. Mill, Alfred Marshall stated that "the law of International Value is but an extension of the more general law of value, which is called the equation of Supply and Demand."¹⁵

¹³*Ibid.*, pp. 258-62.

¹⁴Alfred Marshall, *Money, Credit, and Commerce*, reprints of *Economic Classics*, Augustus M. Kelly, N. Y., 1960, p. 160.

¹⁵*Ibid.*, p. 161.

Supply and demand curves for internationally traded commodities, however, according to Alfred Marshall, depended upon the elasticity of the country's demand for imports and exports. Furthermore, "the elasticity of a country's demand for imports may be measured by the proportionate increase in that demand, which results from any movement in her favour of the terms on which she can obtain them."¹⁶ "The elasticity of a country's aggregate demand for foreign goods is compounded of the elasticities of her demands for various sorts of goods."¹⁷ From this, it may be seen that Alfred Marshall attempted to analyze the behaviour of international trade in terms of the elasticities of Supply and Demand curves.

On this line of reasoning, it may be concluded: "A devaluation of the pound will necessarily increase the dollar value of British imports and hence decrease the demand for dollars; the more elastic is the British demand for American goods, the more will the demand for dollars fall with any given devaluation."¹⁸

Aggregate Spending Approach

Sidney S. Alexander has analyzed the effects of devaluation on Trade Balance in great detail.¹⁹ He has used the Aggregate-Spending Approach or the Keynesian approach as it is more popularly called. He has discarded in the present context the elasticity approach of Alfred Marshall because the partial elasticity approach fails to tackle adequately and appropriately the very many complex relationships governing international trade which devaluation must take into account. Partial elasticities refer to the effects of a change in price on the quantities supplied or demanded "when all other things remain equal." Such conditions impose considerable limitations which may vitiate realistic analysis of the problems relating to inter-

¹⁶*Ibid.*, p. 167.

¹⁷*Ibid.*, p. 175.

¹⁸Richard G. Lipsey, *An Introduction to Positive Economics*, Weidenfeld and Nicolson, London, 1963, p. 462.

¹⁹Sidney S. Alexander, *Effects of Devaluation on a Trade Balance*, International Monetary Fund Staff Papers, Vol. II, 1951-52, pp. 263-78.

national economics. Total elasticities are concerned with the totality of the situations, that is, they take into account the situation when other things have changed that are likely to change as a result of devaluation.

While introducing his Income-Absorption Approach in preference to the Elasticity Approach, Sidney S. Alexander has stated that "the percentage change in price is not generally equal to the percentage devaluation, but itself depends on the same complicated relationships." Therefore, the total elasticities appropriate for the analysis of the effects of a devaluation would depend on the behaviour of the whole economic system and the statement that the effect of a devaluation depends on the elasticities boils down to the statement that it depends on how the economic system behaves.²⁰ For this reason, Professor Alexander has approached the problem by concentrating on the relationship between real expenditure and real income and the relationship of both with the price levels, rather than concentrating on merely traditional supply and demand analysis.

Sidney S. Alexander has based his analysis on the fundamental identity between national income (Y), domestic absorption [consumption (C), investment (I)], and foreign balance [exports (X) minus imports (M)]. He has assumed that a country's net foreign trade balance is equal to the difference between the goods and services produced in the country and the total goods and services taken off the domestic market. The word "absorption" used in the present context was at first used by Kenneth E. Boulding, it meant the sum of consumption plus investment including any change in the holding of inventories. While reviewing the analysis by Sidney S. Alexander, Fritz Machlup has incorporated "government contribution" as a separate component of national income. He considered it as an improvement, but the Keynesian analysis assumes national income (Y) equal to consumption expendi-

²⁰*Ibid.*, p. 264

ture (C) plus investment (I) of the economy in the aggregate, and, as such, the refinement suggested by Fritz Machlup though stressing the significance of an important sectors of the economy is, in fact, analytically redundant.

However, let us examine the contribution of Professor Alexander a little more closely. In his analysis, Professor Alexander has studied the impact of devaluation on the national economy very precisely. He has indicated that devaluation can affect the foreign balance only in two ways, namely,

- (1) It can lead to a change in the production of goods and services in the country; this change will have associated with it an induced change in the absorption of goods and services so that the foreign balance will be altered by the difference between the change in income and the income induced change in absorption.
- (2) The devaluation may change the amount of real absorption associated with any given level of real income.²¹

Sidney S. Alexander has adopted an over-simplified model in order to justify his conclusions though in essence his analysis, he thinks, would "hold good even in the real world."

Sidney S. Alexander has postulated that

$$B = Y - A$$

where B is foreign balance, Y total production of goods and services, and A total absorption of goods and services. This identity is, in fact, identical to what Fritz Machlup²² has stated as

$$Y \equiv C + I + G + X - M$$

where C is consumption, I investment, G government contribution, X exports, and M imports. This identity can be shortened by merging the first three items, namely, C , I , and G representing absorption as A , and the remaining two X and M whose

²¹*Ibid.*, p. 265.

²²Fritz Machlup, "Relative Prices and Aggregate Spending in the Analysis of Devaluation," *International Monetary Economics* by Fritz Machlup, George Allen, London, 1966.

difference ($X-M$) constituting trade balance is signified by B ; thus, we get the same identity as $Y = A + B$ or, $B = Y - A$, which shows that the trade balance must always be the difference between income and absorption.

The fundamental identity can also be written as

$$b = y - a \quad (1)$$

where changes in the quantities are expressed by corresponding small letters.

Effect of Devaluation on Absorption

From this, the effect of devaluation which is expected to influence trade balance, can be examined through its impact on y and a , y and a representing changes in national income (Y) and absorption (A) respectively. Devaluation will affect price level, the level of output and several other economic variables. Changes in the level of income (y) and the propensity to absorb (c) [according to Sidney S. Alexander, propensity to absorb equals the propensity to consume plus an analogous effect of income on investment which may be called the propensity to investment (Fritz Machlup includes propensity to spend public funds also in it)] taken together would be equal to the income-induced changes in absorption (a) plus the direct effect of devaluation on absorption (d). This relationship can be stated as

$$\begin{aligned} cy &= a + d, \\ \text{or. } a &= cy - d \end{aligned} \quad (2)$$

Equation (2) expresses what ver tendency there may be for devaluation to induce any changes in the amount of real absorption at any given level of real income. It indicates that

the change in the absorption of goods and services in real terms as a result of devaluation is made up of two parts. The first, cy , is the change in real consumption plus real investments that is induced by the change in real income that results from the devaluation. The other part, d , is the change in absorption which results other than through the income effect.²³

²³Alexander, *op. cit.*, p. 266.

By combining the fundamental relationship (2) with that of (1), one would get*

$$b - (1 - c)y = d \quad (3)$$

which is very useful in directing investigations to three basic questions, namely, (i) how does the devaluation affect income (y), (ii) how does a change in the level of income affect absorption, that is how large is c , and (iii) how does the devaluation *directly* affect absorption at any level of income, that is, how large is d .

These questions can be effectively answered only on the basis of a comprehensive analysis of the impact of devaluation on the entire economic structure of the devaluing country and the rest of the economy. But, one conclusion that may be drawn from this relationship is the significance of $(1 - c)$, or c itself, in determining the effect of devaluation. Assuming that income increased as a result of devaluation, the devaluation effect upon income and the consequent income effect upon absorption will improve trade balance only if (c) is small than unity. But while the marginal propensity to consume is usually smaller than unity, c which is the combined marginal propensity to absorption may well be greater than unity. In that case, the non-absorbed change the income $(1 - c)y$ will be negative and the trade balance will deteriorate. Only the direct effect on absorption can then, still help matters.

Devaluation Effect upon and via Income

Sidney S. Alexander has further classified the effects of devaluation as the effects upon and via incomes, and as the direct effects upon absorption. In the first case, he analyzes idle-resources effect and terms of trade effect; in the second case, he considers cash-balance effect, income-redistribution effect, money-illusion effect, and other miscellaneous effects.

$$\begin{aligned} *b &= y - a & (1) \\ a &= cy - d & (2) \end{aligned}$$

Substituting the value of a obtained from (2) into (1), we have

$$\begin{aligned} b &= y - (cy - d) \\ &= y - cy + d \\ &= (1 - c)y + d \\ \text{or } b - (1 - c)y &= d \end{aligned}$$

Explaining the idle-resources effect, the possibility of worsening of terms of trade has been mentioned. It could happen if devaluation causes increased utilization of the idle resources induced by increased outlays on consumption, investment (including government expenditures) and on export industries provided there were idle resources already present in the community. This could accelerate industrial activities leading to greater employment and higher levels of income generation. Thus, the existence of idle-resources might enable $(1-c)y$ to increase. In case, $(1-c)$ is negative, the trade balance might deteriorate unless other corrective measures are present.

Under these conditions, if trade balance is to improve, the devaluing country should see that there is no increase in its income and employment, that the propensity to absorb income is less than unity, and/or that the other effects of devaluation are in the right direction and stronger than the idle-resource effect. Sidney S. Alexander has stated: "If c is equal to or greater than unity, the foreign balance will not improve as a result of the increased output. Under such circumstances, the devaluation might be effective in stimulating recovery but not in improving the foreign balance except possibly through direct effect."²⁴ He has further stated:

From the point of view of the devaluing country that has unemployed resources, the effect on income, as well as the favourable effect on the balance of payments if c is less than unity, must constitute the most attractive potentiality of a devaluation. If the country is at full employment, this potentiality does not exist and the effects of devaluation must depend on the more tenuous and less attractive effects on absorption.²⁵

Next, Sidney S. Alexander has analyzed the terms of trade effect of devaluation on foreign balance. This effect is also through the income effect. The expectation that devaluation

²⁴*Ibid.*, p. 267.

²⁵*Ibid.*, p. 268.

will cause decline in export prices in foreign currency is based on the fact and a country's exports are usually more specialized than its imports. As a result of this specialization, export prices are much more affected than the import prices. Unless the imports greatly exceeded exports prior to devaluation, there is every likelihood of the terms of trade becoming adverse. This would cause decrease in income. Professor Alexander measures the reduction in the country's real income associated with the deterioration of the terms of trade by t . Reduced income would reduce the demand for imports as well as that for domestic goods. Therefore t would induce a reduction in absorption by the amount ct . This may improve the foreign balance partly through the eventual transfer to the production of export items or of import substitutes of the resources formerly used to produce the domestic components of ct . The Terms of Trade effect of devaluation on foreign balance will be felt firstly by reduced t , and then by the effect stimulating an improvement on ct , so that the change in the balance associated with the initial Terms of Trade effect on income, t , is $t - ct$ or $(1 - c)t$.

Sidney S. Alexander concludes in this context that "if t is negative, as assumed, and if c is less than unity, then a deterioration in the terms of trade also implies a deterioration in the foreign balance. Only if c is greater than unity will the adverse terms of trade effect improve the foreign balance."²⁶ The aggregate income effect of devaluation may be $(1 - c)$ multiplied by the change in income. The change in income may be caused by idle-resources effect or by terms of trade effect. The former by stimulating the economic activities will have positive effect: the resulting change in income, y , will induce a change in absorption, cy , so that it will result in a change in foreign balance equal to $y - cy$, or $(1 - c)y$. In this case, the negative effect will depend upon the value $(1 - c)t$ as explained before.

Sidney S. Alexander has defined the direct effect on absorption as "any influence toward lower real expenditure as money

²⁶ *Ibid.*, p. 269.

income and money price rise together as a result of devaluation."²⁷ This takes us to the question of monetary preferences and behaviour. The main question to be explored in this context is "why with a given real income, when money incomes and prices rise in the same proportion, there should be a reduction of real consumption or investment."²⁸ As indicated earlier, this line of enquiry can be pursued under four main heads, namely, Cash Balance effect, Income Redistribution effect, Money Illusion effect, and Miscellaneous Direct Absorption effects.

Cash Balance Effect

Cash Balance effect of devaluation on direct absorption runs on familiar lines. Individuals hold money, if the money supply is inflexible, of a particular magnitude depending upon the prevailing price level in the economy. If prices rise, the individuals accumulate more cash. Real income being assumed constant, it is natural to expect that such increases in cash balance would reduce their real expenditures. If increases in cash holdings cause selling of other assets, it might even lead to changes in the rate of interest. This, in turn, might influence real consumption or investment relative to real income. "Thus the cash balance effect may operate *directly* on the income-expenditure relationship through the foregoing of expenditure in order to build up cash, or *indirectly* through the rate of interest as the result of an attempt to shift from other assets into cash."²⁹

It is possible that the reduction of absorption on account of cash balance effect, or of other direct absorption effects, might be directed towards certain domestic goods and services from whose production it is not easy to transfer resources to the production of export items or of import substitutes. This might lead to some unemployment. This would have repercussions throughout the economy. Professor Alexander says, "if c is less than one, the net result of this adverse effect on income

²⁷*Ibid.*, p. 270.

²⁸*Ibid.*, p. 271.

²⁹*Ibid.*, p. 272.

produced would be deterioration of the foreign balance which would tend to counteract the improvement from the direct absorption effects."³⁰

It might be that there is a long lag of wages behind prices, and profits may therefore gain at the expense of wages. Moreover, there may be transfer of income from fixed money income group to the rest of the economy. The impact of such transfers on direct absorption will depend upon the marginal propensity to absorb of those sectors which are involved in these transfers. "To the extent that income is shifted from those with a high marginal propensity to absorb to those with a low propensity, the foreign balance will be improved by devaluation."³¹ In this context, it is also important to note that the redistribution effect will spread not only on consumption goods but also in the investment sector and changes in the tax receipts will have to be considered in relation to the marginal propensity to absorb of the government sector. The final effect of redistribution of income will be the resultant of all these factors.

Money Illusion Effect

People are apt to consider their income, expenditure, and savings mostly in money terms. Taking into account this psychological behaviour, Sidney S. Alexander has suggested that the result on the balance of payments may be favourable if at higher prices people choose to buy and consume less even if their money income has increased in proportion, over and above to what can be attributed to the cash balance effect. "But rising money incomes and rising prices may actually operate in the opposite manner; for example, annual savings may be calculated in money terms and may fail to rise in proportion to money income and prices."³²

Miscellaneous Direct Absorption Effect

The role of price expectations has to be taken into account in relation to the miscellaneous direct absorption effect. When

³⁰*Ibid.*

³¹*Ibid.*, p. 273.

³²*Ibid.*, p. 275.

the expectation of price rise is persistent, it would result in increased absorption with adverse effect on foreign balance. It is said, it would be so, at least, in the short run. Furthermore, when the import prices rise, and if investment goods are also included in this category, the relative attractiveness of imported investment goods would decline in relation to the domestically available such goods, or in relation to their near substitutes. It may, therefore, lead to increased absorption but there is also a possibility that the increased prices of domestically produced goods would be so high that the people may like to postpone or reduce their expenditures on these goods which would lead to greater savings or hoarding.

From the above, it is apparent that a large number of variables become significant for the analysis of the effect of devaluation on the balance of payments of the country. Many of the effects may be transitory, and some of them may even counteract one another. The position may be summarized as follows:

The main conclusion is that the most fruitful approach to the general problem of obtaining a satisfactory foreign balance, and in particular of appraising the effects of the foreign balance of a devaluation is *via* the analysis of the income-absorption relationship. It is theoretically possible to obtain the same answers in terms of supply and demand elasticities, but one is more likely to be misled. It seems more in accord with the realities of the situation to recognize that if the foreign balance is to be improved, the community as a whole must reduce its absorption of goods and services relative to its income. The inquiry can then best follow the line of asking who is to cut his absorption relative to his income, or what is to be the shift of income from those who, on the margin, absorb more to those who absorb less. Supply and demand conditions, in the sense of partial elasticities may be useful tools in this analysis. But the total elasticities for which the conventional formulae alone are

valid, are not only poor tools; they may mislead, or at least obscure the analysis.³³

Income Absorption Approach Reviewed

Fritz Machlup has reviewed the income-absorption approach of analyzing the effect of devaluation and has suggested various improvements in the analysis. Sidney S. Alexander has indicated Idle-Resources effect and Terms of Trade effect as the two sources of increasing the level of income following devaluation. Implicitly, therefore, this rules out the possibility of what Fritz Machlup calls, the resource-reallocation effect. By better utilization of the existing resources and by more economic allocation of available factors of production, it is possible to increase the level of output. As such, the constraint of full employment and absence of idle resources, which are indicated by Professor Alexander to work in an adverse manner by increasing propensity to absorb and thereby reducing foreign balance may not in fact hold true if the level of output could be increased by organizational efficiency but without affecting the level of employment or straining the already existing level of resource utilization. Fritz Machlup thinks that the resource-reallocation effect of devaluation may be especially significant when "idle-resources effect is negligible or zero; total employment may remain practically unchanged while the output produced may increase through a more economic or more efficient use of the resources employed. But it is also possible that both effects operate at the same time; more or fewer resources may be employed in a more or less economic way."³⁴ Furthermore, there is also the possibility of real income increasing as a consequence of operational efficiency and substitution effects. Under the situation of unrealistic exchange rates, trade and production are carried out not necessarily in the best possible way. Devaluation leading to realistic exchange rates might by introducing the inducement to optimalization of resources lead to more economic use of resources with a consequent increase in real income.

³³*Ibid.*

³⁴Fritz Machlup, *op. cit.*, p. 182.

This might be accompanied by other economy measures.

Fritz Machlup enumerates two other incidental advantages. Generally, in such economies where overvaluation of national currency has been made and the economic activities are based on this fact, the government has to impose direct controls in order to safeguard several other adverse social repercussions. When devaluation permits elimination of some controls and fosters improvements, the administrative cost of government and business is considerably reduced. The second effect is the improvement in efficiency due to revival of competition. Devaluation might reinstate the resource allocation function of the price mechanism and remove quota system with its bureaucratic allocation of foreign exchange and imported materials. Such improvements might augment the foreign balance even under the conditions of full employment and full utilization of available resources. The surplus may be directly mobilized for export purposes thus increasing the magnitude of $(X-M)$.

The Effect of Substitution Process

Fritz Machlup then considers the impact of substitution effect. He emphasizes the fact that the condition of rising price levels having direct influence on absorption needs to be modified for incorporating the role of changes in relative prices leading to substitution effect. Devaluation does alter the relative prices which cannot be neutral. Devaluation aims at reducing the export prices of domestic products and increasing the import prices. It would, in fact, have serious impact on the relative prices of the different items available in the country and it would also induce changes in absorption. In order to illustrate his point, Professor Machlup assumes for example (in order to isolate the outcome examined here from any terms-of-trade-effects) that devaluation leaves the terms of-trade unchanged, lifting the domestic prices of exports and of imports by the same percentage. As imported goods are now relatively higher in price than domestic goods, substitution in consumers' plans seems inevitable; and as exportable goods are relatively higher in

price than domestic goods, substitution in producers' plans seems inevitable; transfer of productive resources will ensue, and the increased demand for import substitutes together with the reduced supply of domestic goods from the production of which resources have been diverted cannot but cause relative price movements which are apt to reduce the real value of aggregate absorption even if total money expenditure should be somewhat higher than before.³⁵

By extending the analysis of substitution effect even on the Terms of Trade effect of devaluation, Fritz Machlup considers that "Alexander's conclusion that the ultimate terms of trade effect upon the balance of trade would be $(I-c)t$ or equal to the income effect times the marginal propensity not-to-absorb, is wrong."³⁶

Fritz Machlup further suggests that the income-absorption analysis of Sidney S. Alexander does not show the causal relationship between the various factors, rather it describes only the *ex-post* conditions. He is of the opinion that the Fundamental Equation in the analysis of Professor Alexander may be "misleading if it is deemed to show causal (*ex-ante*) rather than classificatory (*ex-post*) relationships." In order to substantiate his point, he gives an example of an increase in consumption expenditure which may

result in an increase in Y (if employment rises) or a decrease in I (if inventory is depleted) or a decrease in X (if exportable goods are domestically used) or an increase in M (if imports are purchased) or no real change at all (if prices of consumption goods rise); and there are many other more indirect possibilities and combinations—the study of which may be underemphasized by over confident reliance on the "insight" afforded by the equation.³⁷

In this and in many other ways Fritz Machlup has showed that the analysis of Sidney S. Alexander though significant in

³⁵*Ibid.*, p. 183.

³⁶*Ibid.*, p. 184.

³⁷*Ibid.*, p. 186.

many ways should be approached cautiously for its practical applications. The income-absorption approach is indeed an application of the Keynesian tools to the problems of international economics, but this branch of economics has to consider both sides of the transactions. Devaluation is a decision of Country *A* whose impact on Country *B* could be assessed only after taking into account the effect of devaluation on Country *A* as well as the adjustments made in Country *B*. Sidney S. Alexander as well as Fritz Machlup, both have overlooked the conditions pertaining in Country *B* following devaluation in Country *A*.

Summing Up

Obviously, while summing up the various threads of the analysis it is clear that the analysis of the effects of devaluation will have at first to take into account the exportable surplus augmented as a result of this decision. Exportable surplus can accrue because a larger total output in the country enables it to have the same after satisfying the domestic demand; if the national output cannot increase even to maintain the same level of exportable surplus, the domestic consumption—absorption—must diminish. National output and absorption are two major variables whose behaviour must be examined carefully in order to find out the efficacy of devaluation. These variables can be influenced by many factors: if the willingness of the workers increases to put in greater amount (or intensity) of work for the same wage-rate without drawing upon the national output by increasing their consumption, the country can be able to generate a little larger exportable surplus. But no amount of the increased availability of exportable surplus can augment the foreign balance of the country unless there are buyers of the stuff. Though this is a very elementary principle, yet it is often overlooked. Devaluation aims at inducing external buyers to purchasing more of the goods and services of the devalued country. Unless they buy the stuff, the devaluation would fail in its objectives; but in order to achieve this objective, the

response of others to the devaluation decision of Country A should be helpful.

Unless external demand picks up, devaluation by itself would fail to augment foreign balance. The increased availability of exportable surplus without adequate external demand might lead to inventory accumulation, massive unutilized capacity and beginning of the recessionary symptoms in the economy. Devaluation decision must therefore be cautious and careful. Unless bold monetary, fiscal, and other necessary control measures are administered in the devaluing country, there is every danger that devaluation, by releasing many disturbing economic forces, might prove to be a dangerous recipe. Therefore, it is necessary that the preconditions for the success of devaluation should be appropriately taken into account and necessary preparation made before finally deciding devaluation of one's national currency.

Preconditions for the Success of Devaluation

It is necessary that the devaluation decision must be preceded by careful preparations. Firstly, the objectives of devaluation must be clearly and precisely defined. This presupposes a comprehensive examination of the difficulties facing the country and the possible solutions of the difficulties. The magnitude of devaluation is very vital in creating an impact; but this can be decided only on the assessment of the deviation of the official par value from the real.

Secondly, the economy should be prepared for an adequate dose of devaluation. This is necessary because the industrial structure of the devaluing country must be responsive to absorb the forces generated by this decision. A well diversified and efficient economic base is essential for sustaining international competition. Exports can be encouraged when the goods are cheap, attractive, and durable. Labour legislation, price controls, allotment of scarce industrial inputs, provision of fiscal incentives and other tax subsidies must be adjusted in such a way that they encourage and aid expansion of the export sector

of the economy. This should be pushed to the extent where special encouragement to the export industries does not unduly cause hardships to the domestic sector.

Reorganization of the productive machinery, introduction of the higher technology and planning better, strategy for obtaining economies of scale must be incorporated in the economic system. If exportable items have larger import content, the efficacy of devaluation would be minimized. The economy should be given export orientation; sophisticated items with larger export markets may be manufactured, expanding network of export organizations must be established and quality of the products must be substantially improved. Many of these steps should precede the final devaluation decision so that the economy is soon geared to the expanding export trade.

Thirdly, the grim determination of the nation to succeed must be there in the hearts of the people. This is a difficult task involving social as well as economic dimensions. Corruption at high and low levels must be eradicated. This would give the real morale boost up. As long the workers are not told the real implications of increasing their productivity, merely increases in investment outlays with increasing propensity to absorption could not help the economy. But, this can be done only when right social guidance is available.

Devaluation to succeed would involve diversion of resources to some extent at least from the household sector to that of exports. This might mean deprivations. People will have to deny themselves the possibility of better standard of living, more diversified consumption possibilities and extensive foreign travel. Such sacrifices can be voluntarily forthcoming from the masses only when examples are given by the leaders. The element of compulsion would not induce lasting favourable response. Trade Unions have to be more disciplined and restrained. Manufacturers have to foster greater quality consciousness, greater managerial efficiency and respect for their products in domestic as well as in external markets. Workers will have to work more intensively without insist-

ing on higher wages: in fact, the wage rate should be substantially lower than their productivity in order to enable the commodities to compete in external markets. This would necessitate a sense of urgency impressed on all sections of the population with necessary social, economic, administrative, and political orientations. Unless such preconditions are achieved, in many cases, even drastic devaluation measures would fail to achieve its objectives.

Indian Case of Devaluation

The role of devaluation in accelerating the industrializing process and in eradicating developmental difficulties particularly in an underdeveloped country has recently been recognized. The Indian experience of devaluation in 1966 shows various aspects of this problem.

The Bell Mission Report

In the Indian context, the need for devaluation was emphasized by the Bell Mission Report on India. At the instance of George D. Wood, then Chairman of the International Bank of Reconstruction and Development, Bernard R. Bell visited India with a group of experts in 1964. The Mission studied the various developmental problems confronting the country. The Report was submitted to the I. B. R. D. in September 1965 which listed the many deficiencies of the Indian economy and suggested ways and means for overcoming them. Devaluation was assigned a high place among the steps recommended. But, the success of devaluation decision, the Bell Mission emphasized, would depend on several economic adjustments in the devaluing country and on softening of the attitude of advanced countries towards the Indian exports. In the former category, suggestions were made for the removal of direct administrative controls on the imports of industrial inputs, larger allocations of resources for intensive development of agriculture with a view to doubling the rate of its growth, restraint on defence expenditure, liberalization of controls over the distribution of raw materials and over their prices; the

Mission also suggested modifications in the planning technique, reforms in the management of public undertakings and improvements in research, investigations, allocation, and dissemination of technical data.

On the part of the industrialized nations, the Mission emphasized that they should relax quantitative controls against the semi-processed and manufactured articles of India and provide softer loans which did not impose excessive burden on the country. Given these conditions, Bell was confident that India could achieve accelerated rate of growth eventually leading to a self-sustaining economy. The overvaluation of the rupee, according to Bernard R. Bell, worked directly to defeat the possibility of massive import substitution and export expansion essential for achieving the objectives of the development programme.³⁸ "In the long run, we would expect," the Bell Mission reported, "exports stimulated by an appropriate exchange rate and other measures to provide an increasing part of the growing requirements of maintenance imports."³⁹

Devaluation Decision

Ever since the submission of the Bell Mission Report, and even earlier, different forums in India have been discussing the possibility and desirability of devaluation. Many eminent economists, industrialists, administrators, and politicians took active part in the discussions. The final decision, however, seemed difficult and it was being postponed for one reason or the other. Eventually, at the end of 5 June 1966, Finance Minister Sachin Chaudhry, despite several denials on earlier occasions, announced the devaluation decision along with several other corrective measures adopted with a view to helping the country "in our march towards self-reliance."⁴⁰ As a result of this

³⁸*Devaluation of the Rupee and its Implication*, Institute of Constitutional and Parliamentary Studies, New Delhi, 1966, Appendix IV, pp. 193-9.

³⁹*Ibid.*, p. 199.

⁴⁰Finance Minister's Broadcast, 5 June 1966.

decision, par value of the rupee was changed from 18.66 grams of gold per hundred rupee to 11.85 grams of gold. This meant a reduction in the external value of the rupee by 36.5 per cent, that is, the Indian rupee on the night of 5 June 1966, was devalued by 36.5 per cent. As a result of this magnitude of devaluation, the Reserve Bank of India was obliged to provide Rs 7.5 per US dollar supplied to it as against Rs 4.16 earlier; in exchange of a British pound sterling Rs 21 would be supplied as against Rs 13½ given earlier. It was stipulated that the same rate of conversion would be adopted for supplying rupees against other foreign currencies.

While announcing the devaluation decision, Finance Minister Sachin Chaudhry explained the urgency of such a step. The price of foreign exchange did not any more reflected economic realities, whereas the short-term palliatives had failed to correct the imbalance. A radical measure of substantial devaluation as decided then was intended to correct the imbalance and to provide stability and strength to the economy. Sachin Chaudhry stated that the general level of prices was 80 per cent more than what it was ten years ago whilst the official par value of the rupee had remained unchanged since 1949. The increasing level of internal prices had gone out of alignment with world prices creating much resistance against Indian exports. Development, however, required larger imports and imposed greater burden of debt repayments. These obligations could be met only by raising the export level which had however failed to respond to short-term promotional measures. Import entitlements to exporters, direct subsidy, tax credit certificates, and several such export promotion measures had not succeeded in eradicating the difficulties facing the export sector. It was realized that any radical reformation in exports was impossible without disciplining the internal prices. Such measures, according to Finance Minister, succeeded only to a limited extent. He further stated: "Had our difficulties been temporary in character, they might even have been enough to restore our competitive position. But, experience has clearly demonstrated that our

difficulties are more basic.”⁴¹ The import entitlement scheme was based on creating artificial scarcity conditions to compensate exporters. But, the need was for fuller utilization of existing capacities and establishment of new industries which necessitated much greater imports of raw materials and components. But this would bring down the effectiveness of import entitlement schemes. Other methods of tax credit certificates and direct subsidies would increase “intolerable strain on our budgetary resources which are so badly needed both for the development and the defence of the country.”⁴² Furthermore, they carried the danger of retaliation by countries to whom India exported. Therefore, it was necessary to find out a more enduring and reliable device for increasing the competitive power of Indian exports. For this purpose, a change was made in the par value of rupee. As a result of the new exchange rate the Indian exporter was accorded substantial encouragement: 100 US dollar under the changed rate would now give Rs 750 as against Rs 476 earlier, whereas the importers would get much less for the same amount of their expenditure; 10 British pound sterling would now fetch Rs 210 worth of Indian goods and services as against Rs 133 earlier. Thus, by providing adequate incentive to Indian exporters, devaluation was expected to provide substantial assistance for economic development.

Other Objectives of Devaluation

Devaluation was also expected to quicken the pace of import substitution. Finance Minister Sachin Chaudhry indicated that devaluation would raise the rupee cost of imports, as such there would be greater incentive for fabricating many items domestically which were earlier imported from abroad. Investments in import substitution industries could thereby be encouraged. Enduring encouragement to exports as well as import saving activities aimed at fostering all round self-reliance in the country could in this way be given to those who were willing to take advantage of the situation and help the nation.

⁴¹*Devaluation of the Rupee*, p. 182.

⁴²*Ibid.*, p. 183.

Having explained the different ways in which devaluation could assist Indian economic growth, Finance Minister Sachin Chaudhry concluded as follows:

To sum up, devaluation would provide a better corrective to price rise and distortions of the past than the remedial measures we have pursued so far. Even more important, it will facilitate a better allocation of our resources and strengthen our foreign exchange position on an enduring basis. With renewed determination and discipline on the part of all of us to hold inflationary pressures firmly in check, it would be a major ally in our march towards self-reliance⁴³

Corrective Measures

Consequent upon the devaluation decision, several significant changes were introduced in import trade policy, exchange control orders and in institutions connected with international trade. Firstly, mention may be made of the adjustments made in the value of import licences. Those licences which were issued immediately prior to devaluation and were likely to fructify during the following period could not sustain the stipulated level of imports unless the old value was validated for the new par value of the rupee. Similar adjustments were necessary in several other cases as well. The rupee value of unutilized pre-devaluation import licences and those others issued between 6 June 1966 and 10 June 1966 was raised upwards by 57.5 per cent in order to maintain the foreign exchange value of these licences. Similarly, the value of quota licences issued to established importers in respect of certain essential commodities such as motor vehicle parts, X-ray films, etc., was also raised; the rise in value ranging from 5 per cent to 75 per cent depending upon the essentiality of the articles concerned. Scales on which foreign exchanges for travels abroad for various purposes such as medical treatment and studies abroad were concerned were

⁴³*Ibid.*, p. 187.

also enhanced by 57.5 per cent in terms of Indian rupee. The maximum limit of Rs 1,500 per month of remittances prescribed for foreign nationals to their respective countries was raised to Rs 2,360 per month or up to a ceiling of the amount of monthly averages of their remittances during the preceding twelve months. During the course of the year, an upward revision of the free limit in respect of imports by parcel post for private use, Haj pilgrims and remittances made by authorized dealers for purposes such as Patent or Trade Mark, Registration fees, subscriptions, membership fees to clubs, etc., was also made. In October 1966, it was also decided to grant limited exchange facilities to persons going abroad for business and other approved purposes, medical check-ups and consultations provided a specialist recommended such a check-up or consultation.

Liberalized Imports for Export Industries

Imports related to export industries were given favourable treatment. With a view to stepping up production, specially in the export sector, imports were substantially liberalized and duties reduced to keep the cost of essential imports in line with the cost of comparable domestic products. In August 1966, the import policy for registered exporters in order to cover the import requirements of specified export industries was also announced. The new policy aimed at replenishing the import content of export industries in terms of raw materials and intermediates, components, and spares against the exports already made by them on or after devaluation. The industries covered under this policy related to engineering goods, chemicals, drugs and pharmaceuticals, glass and glass-ware, ceramics, rubber products, paper and paper products, leather and leather goods, handicrafts, sports goods, woollen carpets, rugs and druggets, woollen textiles, hosiery, etc., and mixed fabrics, unmanufactured tobacco, cigars, cigarettes and bidis, coir products, processed foods, cotton textiles, cashew kernels, stainless steel products, ship repairs, natural silk fabrics and garments, gems and jewellery items, cinematograph films exposed, and readymade gar-

ments of cotton and woollen fabrics or of wool and synthetic fibres.

Import entitlement and tax credit certificates which so far had been important export promotion schemes, were terminated. Instead, a new scheme was started under which the registered exporters were provided with replenishments of import contents in terms of raw materials, intermediates, components, and spares against exports of specified products. The registered exporters who were themselves manufacturers of export products or of components and raw materials thereof were made eligible to receive import licences in their own names. They could even nominate a similar other manufacturer to receive the licence against the exports made by them. A registered exporter who himself was not a manufacturer of export items was not eligible for a similar licence in his own name, but he could nominate one or more manufacturers of similar products to receive licences against the exports effected by him. Import licence issued under this scheme could be utilized up to one-fifth of the value of the licence or rupee one lakh for the importation of permissive types of jigs, tools and equipment for packing and tagging. Such imports, however, could be used for production only in the units owned or managed by the licensee. This scheme could facilitate manufacture of export items and ensure safeguards against misuse of the concessions granted to export sector.

Import Liberalization for Agricultural Inputs

As a large proportion of export industries depended upon the agricultural sector of the economy for the supply of necessary raw materials, and as the development of agriculture was vital even from other considerations, it became necessary after devaluation to consider the needs of agriculture and of certain other industries otherwise important. The import liberalization following devaluation therefore took into account the requirements of agricultural development. Special arrangements were made to import fertilizers, pesticides, sulphur, and rock phosph-

hate. Raw materials needed by such industries as jute textiles, cashew nut, processing and tanning leather were allowed to be imported under Open General Licences which in the first instance were valid for shipment up to 31 March 1967. In this connection, mention may be made of the 59 Priority Industries mainly concerned with the production of items important for domestic economy or for exports. The requirements of these industries were met on a continuing basis after they have utilized the already imported items. It was decided that the full requirements of raw materials, components, and spares of these industries would be met for six months at the first instance and supplementary licences were issued to them when the commodities thus available were finished. With this stipulation it was expected that the priority industries could continue working without any interruption.

Fiscal Adjustments

Some fiscal adjustments were also necessary in order to eliminate windfall profit to certain sections of the exporters. World demand for many items have been price inelastic. Consequently, the changes in exchange rate could produce windfall profit to them. This being unintentional, countervailing adjustments were necessary. Therefore, export duties were levied on a large number of such staple exports as jute manufactures, tea, iron ore, coffee, tobacco unmanufactured, black pepper, and mica. Such dutiable items accounted for over 60 per cent of the total exports of India. This levy was aimed at, besides diverting into exchequer a part of the windfall profit arising due to devaluation, preventing of any fall in export earnings in terms of foreign currencies. The duties initially imposed were continuously reviewed, and adjustments in the rates were made from time to time in the light of subsequent developments in costs, international prices and demand.

On the other hand, there were new enterprises which were expected to spend abroad in order to build markets for their products. Such industries like engineering goods, iron

and steel, chemicals, and woollen carpets had larger export potential but they needed assistance at the early stages of their development. In order to help them so that they could take advantage of devaluation, even cash assistance was accorded to them.

Quality Control and Pre-Shipment Inspection

Quality control and pre-shipment inspection which at the moment covered more than 85 per cent of exports, after devaluation, were extended to items like de-oiled rice bran and gum karanja while action was also taken to bring under the scheme a number of commodities like light engineering products, crude drugs, rose wood, human hair, coriander seed, etc.

Steps were also taken to safeguard against an unusual rise in import prices. This was necessary in order to maintain stability in the cost of production as well as to secure adequate supply of essential articles. Import duties on all such items of imports, excepting on non-essential consumer goods, were reduced. It was done to such an extent that imported cost of essential raw materials, intermediates, machinery and spares broadly fell in line with comparable domestic products. The regulatory import duty of 10 per cent *ad valorem*, introduced in February 1966, was abolished. Arrangements were, however, made to obtain larger quantity of kerosene, copra and sunflower oils to supplement the needs of mass consumption, and soya bean oil, palm oil and tallow to meet the requirements of soap industry.

Review of Devaluation Decision

During the last several years, India's balance of payments has been in deficit: in fact, persistent deficits have occurred over the last few years. As it would be seen from Table 1, India had trade deficits since 1948, whereas balance of payments on current account has shown persistent deficit since 1956-57, the magnitude of which, however, has been colossal during the recent years. It may also be observed that foreign exchange

reserves have been declining rapidly. From this table, it would be seen that trade balance which amounted to (—) Rs 49.58 crores in 1950-51 amounted to (—) Rs 165.35 crores in 1955-56, (—) Rs 479.55 crores in 1960-61, and (—) Rs 604.47 crores in 1965-66. Similarly, balance of payments on current account (net) which was Rs 38.9 crores in 1950-51 accounted for only Rs 6.7 crores in 1955-56, but in 1965-66 it was (—) Rs 622.7 crores. India's foreign exchange reserves dropped from \$ 2161.3 million in 1950-51 to \$ 1895.0 million in 1955-56 and to \$ 625.8 million in 1965-66. Evidently, these have been symptoms of 'persistent deficits' signifying fundamental disequilibrium

TABLE I
INDIA'S BALANCE OF PAYMENTS AND FOREIGN
EXCHANGE RESERVES

Year	Trade Balance (Rs Crores)	Balance of Payments on Current Account (Rs Crores)	Foreign Ex- change Reserve (\$ Million)
1950-51	(—) 49.58	38.9	2161.3
1955-56	(—) 165.35	6.7	1895.0
1956-57	(—) 464.3	(—) 312.3	1430.3
1957-58	(—) 639.5	(—) 427.0	884.5
1958-59	(—) 453.7	(—) 326.1	795.7
1959-60	(—) 301.3	(—) 185.1	762.1
1960-61	(—) 479.55	(—) 451.7	637.6
1961-62	(—) 431.05	(—) 357.5	624.6
1962-63	(—) 446.16	(—) 446.7	619.7
1963-64	(—) 429.61	(—) 458.3	642.2
1964-65	(—) 532.73	(—) 645.9	524.3
1965-66	(—) 604.47	(—) 622.7	625.8

SOURCE: *Reports of Currency and Finance*, R.B.I., Bombay; *Economic Surveys*, Ministry of Finance, New Delhi.

Rise in Aggregate Absorption Level

Effect of devaluation on recovery of the Indian economy and on improvements in its foreign balance can be examined, as indicated earlier, in terms of relationships between the changes in national income, propensity to absorb and other factors influencing absorption. National income of India in 1966-67

increased to Rs 23,120 crores as against Rs 20,340 crores in 1965-66 and Rs 20,430 crores in 1964-65. Unless the marginal propensity to absorb has been less than unity, the trade balance was expected to deteriorate. Empirical data on marginal propensity to absorb are not available, nonetheless, indirect evidence on expenditure levels has suggested that devaluation has not reduced the level of personal expenditure. Working class index number of consumer prices increased from 185 (1949=100) in June 1966 to 161 in August 1967 which shows that even in order to maintain the old levels of consumption the consumers had to have larger cash balances and they had to spend a larger amount of money. Rise in wholesale prices also did not indicate that the consumer demand had been diminishing and such supply curve shifting leftward. Even investment expenditures did not show any such declining trend. Permission for the issue of Rs 459.3 crores of capital was granted in 1966-67 as against Rs 275.8 crores in 1965-66 and Rs 372.3 crores in 1964-65. Total expenditure of Central and State governments also increased substantially during this period: from an expenditure of Rs 5,479 crores in 1965-66, it increased to Rs 6,492 crores in 1966-67. Evidently, it would be justified to assume that the marginal propensity to absorb of the Indian economy has been much more than unity contributing to deterioration in balance of trade following devaluation. This conclusion does not seem vitiated even by taking into account other effects through terms of trade.

Deterioration in Balance of Trade

The first objective of devaluation, namely, to improve the balance of payments situation has not, obviously, been achieved. In fact, the balance of trade has deteriorated further. As against an adverse balance of trade of Rs 604.6 crores in 1965-66, Rs 532.7 crores in 1964-65, and Rs 429.6 crores in 1963-64, the balance of trade taking into account pre-devaluation and post-devaluation figures together, amounted to (—) Rs 806.3 crores in 1966-67. The effect of devaluation in re-

ducing the level of imports and increasing that of exports has also not been heartening. The pattern of Indian imports has been such that any significant reduction in the total quantum of imports could not be possible without straining essential domestic supplies for consumption and investment purposes. Various liberalization measures adopted after devaluation also did not aim at curtailing these supplies. Consequently, one finds that the merchandise imports excluding special food assistance from Canada, Australia, the USSR, and other countries, accounted for Rs 2078.4 crores in 1966-67 as against Rs 1410.1 crores in 1965-66, Rs 1349 crores in 1964-65, and Rs 1222.9 crores in 1963-64. As far as exports are concerned, they increased to Rs 1156.5 crores in 1966-67 as against Rs 805.6 crores in 1965-66, Rs 816.3 crores in 1964-65 and Rs 793.2 crores in 1963-64. This increase has been made possible by a rise in export prices, rather than by any significant increase in its quantum. The volume index number of exports declined from 132 (1950 = 100) in 1964-65 to 124 in 1965-66 and 119 in 1966-67 though the Value Index has shown increases from 107 in 1964-65 to 113 in 1965-66 and 169 in 1966-67.

Even as far as tourism is concerned, there has not been any marked improvement. In an in-depth survey conducted by the Pacific Area Travel Association in 1967, it has been indicated that India elicited more unfavourable than favourable associations from the tourists. The survey covered 26 countries of the Pacific region and in the Report's list of unfavourable associations per visitor, India tops the list. This is so, specially when 60 per cent of India's present tourist trade accounts for American visitors, who were expected to increase more after devaluation. The Report has indicated the possibility of India losing popularity unless the existing unfavourable conditions which are not necessarily connected with par value of the rupee are substantially altered.

Prospects for Foreign Investment

As far as foreign investments are concerned, similar apprehen-

sion has been expressed by G. L. Mehta, Chairman of the India Investment Centre who has stated that while many industries would not have come into existence but for the technical know-how and skills obtained from abroad, foreign collaboration has not been of marked significance in strengthening India's competitive ability particularly in regard to exports. One of the important causes of it according to G. L. Mehta has been the political instability of the country. "It seems that an element of political instability has also become a deterrent factor for the first time." In this climate, Mehta says, "it is understandable that the foreign visitor is not attracted to invest capital or set up a joint venture in this country." Similar opinions have been expressed by other foreign investors as well.

General Assessment

Economic consequences of devaluation on many of the economic variables such as exports, prices, public finance, balance of payments, burden of public debt, income growth, rate of savings, and provision of necessary wherewithals for the Fourth Five Year Plan have not been very heartening.⁴¹ Devaluation, in fact, gave rise to genuine fear that the internal purchasing power of the rupee will be reduced drastically by a general rise in the price level. The domestic prices have not been stabilized, as hoped by the then Finance Minister Sachin Chaudhry. The gap in balance of payments has not been reduced. Debt servicing obligations have increased. Industrial cost structure has not shown any movement towards greater efficiency. International price differentials have also not been minimized. The cost of managing devaluation by way of concessions to importers and re-sale price maintenance of imported essential consumer articles such as foodstuffs, kerosene, fertilizers, etc., has indeed increased the burden on State Exchequer. By increasing the cost of imported articles, devaluation has increased the difficulties of the Fourth

⁴¹"Economic Consequences of Devaluation," *Yojana*, Planning Commission, New Delhi, 26 June 1966.

Five Year Plan Even Prime Minister Indira Gandhi has been reported to have indicated that the devaluation was not the solution howsoever necessary it might have been for tackling our problem

In accentuating our difficulties, the devaluation of the United Kingdom pound sterling on 19 November 1967 has also played an important role. The extent of devaluation being 14.3 per cent, the new exchange rate of one pound sterling equalled United States dollar 2.40 as against the old rate of \$ 2.50, the new exchange rate of a pound was equal to Rs 18 instead of Rs 21 previously. Following the British devaluation, a large number of countries such as Ireland, Israel, Hong Kong, Denmark, Spain, Fiji, Malta, Bermuda, Guyana, Malawi, Cyprus, New Zealand and Ceylon also devalued their currencies. Ceylon devalued its currency by 20 per cent but imposed a 10 per cent duty on tea exports. Although Pakistan did not devalue its currency it abolished its 10 per cent export duty on jute and cotton to counter the effects of sterling devaluation. The exchange rate of the Indian rupee in terms of gold or US dollars remained unchanged.

Deputy Prime Minister Morarji Desai, on the occasion of the pound devaluation, stated that this step would make the Indian imports from the United Kingdom cheaper, in terms of the Indian rupee the budgetary burden would also diminish, the reduced rupee value of British aid would not affect the purchasing power of that aid in terms British goods and services, and in fact, improvement in British balance of payments position would improve her ability to provide development finance to India. Morarji, however, anticipated that some of our commodities may face difficulties but the demand for other products imported by us may remain unaffected. On the whole, it is not expected that there will be any substantial adverse effect of it on our exports.¹ As to the effect on Indian sterling reserves held abroad, Deputy Prime Minister stated, "while this component of our reserves has come down in value in terms of

¹ *Commerce*, 25 November 1967, Bombay.

gold, its value for meeting our payment obligations in the United Kingdom remains unchanged."⁴⁶ But, as almost all the major traditional export earners of India, namely, tea, jute, cotton and cotton textiles, hides and skins, tobacco, and oil-cakes depended to a great extent on the British market, the initial reaction has been that the British devaluation would seriously jeopardize the Indian prospect of recovery. Indian exports have already been declining during the last few years. Steps taken by Ceylon and Pakistan to lower their prices particularly of tea, jute and raw cotton, which are bound to affect the manufacturers of textiles and jute goods in these countries, would inevitably affect the Indian competitive position adversely. Manubhai Shah has even pointed out that this would have far greater effect than ordinarily expected. "The lowering of prices in the UK market will mean a three or four times greater loss in these products in the world markets."⁴⁷

It is difficult to distinguish the effects of British and Indian devaluations on the Indian economy, but there has been a general consensus that the Indian devaluation has not created the result expected of it. Ramanbhai Amin, ex-President of the Federation of the Indian Chambers of Commerce, has emphasized the absence of necessary preparations which failed devaluation in achieving its desired objectives.⁴⁸ Among the factors listed, he has stressed the importance of stability in the economy, and the need for reducing cost structure of the industry in order to foster competitiveness. Indeed, the most important shortcoming of devaluation decision has been its inability to influence the foreign importers except indirectly through price reduction. But, international economic relations are guided by many other non-economic considerations.

⁴⁶*Ibid.*

⁴⁷Manubhai Shah, "Threat to Our Exports," *Commerce*, 2 December 1967.

⁴⁸Ramanbhai B. Amin, "Economic Implications and Consequences of Devaluation," *Devaluation of the Rupee*, pp. 45-55.

Summing up

To sum up, the significance of devaluation on the recovery of the economy and correcting persistent deficits in its balance of payments cannot be denied. Devaluation, however, exerts its influence through direct and indirect channels affecting propensity to absorption, income effect and substitution effect resulting from changes in relative prices, and other direct and indirect effects on absorption. It has to take into account the competitive position of other countries, as well as the price elasticities of demand for the various commodities exported from the devaluing country. Even, non-economic factors have to be reckoned in this connection.

As far as India is concerned, there has been pressing and urgent need for devaluation. But, the time at which this decision was taken, probably, was not appropriate. Increased cost of capital stock would certainly affect the growth rate of the country vitally when the unutilized capacities already built-in are exhausted.

At a time, when external demand for the Indian products did not have much chance of picking up, and when internal demand for imported capital and for all kinds of domestic products has been increasing, devaluation could not hope to achieve its objectives. British devaluation of the pound sterling which came soon after Indian devaluation has further thwarted the possibility of Indian recovery. The Indian devaluation decision illustrates how an effective weapon of economic administration could be blunted if wielded at an inappropriate time and without making necessary preparations

CHAPTER IV

EXPORTS

IN THIS CHAPTER, we would discuss some problems of Indian exports. In fact, this problem is vitally important for all developing countries. Developmental efforts require larger imports which can be paid for by increased export earnings. Even with substantial foreign aid poured into the economy, the need for augmenting export receipts is great in order to pay for amortization and interest payments. Ex-Governor of the Reserve Bank of India P C Bhattacharya has succinctly posed the problem by stating that "ultimately, it is the exports which have to pay for our essential imports, the volume of which is bound to grow with the development of the economy and also to provide the wherewithal for the mounting debt service obligations." From this, it is evident, that the export sector has not only been the "key propulsive sector," as in some cases, but it is, in fact, the most important plank on which the entire structure—the magnitude as well as the pattern—of developmental activities would depend.

A Complicated Task

Export promotion is a difficult and complicated task. No developing country can increase its export earnings by its own unilateral decision, the cooperation of importing countries is essential for such a programme to succeed. This has imparted tremendous significance to such international organizations as the UNCTAD. Both the contracting parties must cooperate to assist the developmental plans of the backward countries. Such proposals of cooperation are, however, beset with many difficulties. The developed countries have a strong tendency to trade among themselves. The developing countries have generally been precluded from partaking the gains of industrialization in advanced countries. Ragnar Nurkse has shown

that the trade of the developed countries between themselves has been increasing whereas that between the developing and the developed countries has been declining. This tendency was further accentuated by the fact that the demand for primary products, mostly grown in backward regions of the world, has not maintained the same rate of increase as the tempo of industrialization in advanced countries where most of the demand for such products originates.

The situation was radically different in the nineteenth century. During that period the exports of primary products increased much more rapidly than the exports of manufactured goods. This situation has now radically changed. "The expansion of external demand for the primary commodity exports of the poorer countries appears in recent years to have lagged behind the rate of increase in both the exports and national income of the industrial countries."¹ Similar opinion has also been expressed by Manubhai Shah, who has stated that "the share of the developing economies in the total world exports declined from 34 per cent in 1950 to 20 per cent in 1966; that of the developed market economies increased from 60 to 68 per cent and that of the centrally planned economies increased from 8 to 11 per cent during the same period". This suggests that the prosperity of the industrialized nations has not been evenly shared by the developing and the advanced countries, which apart from its other consequences, has added to the export difficulties of the developing countries.

Deterioration in Terms of Trade

Difficulties of the developing countries have been many. Even the terms of trade have been deteriorating for the primary producers. Till recently, the newly industrializing countries have been the chief suppliers of primary raw materials to the industrialized nations. But, the demand for such items has

¹Ragnar Nurkse, *Pattern of Trade and Development*, Basil Blackwell, Oxford, 1961, p. 53.

²Manubhai Shah, *Developing Countries and UNCTAD*, Vol. I, Bombay, Chapter III, p. 18.

been declining. There has been a shift in the pattern of industrial production. Presently, there is greater emphasis on heavy industries. The raw material content of these lines of production has been low. Moreover, there has been an increasing tendency of substituting synthetic and other man-made substitutes for natural rubber, natural cotton, natural jute, etc., there has also been greater use of a few basic elements of mostly local origin. Furthermore, economy and better utilization of scarce raw materials have also reduced the demand for the exports of developing regions.

It has been for such reasons that Ragnar Nurkse has concluded that there had been a relative decline in the importance of primary producers. This conclusion has been reinforced even on the basis of empirical studies. It has been stated that the terms of trade between primary production and manufactured products did deteriorate between 1870s and 1930s; the index fell from 111 in 1870 to 75 in 1938 (1913 = 100). A United Nations study has indicated that "the secular trend in prices of primary commodities relative to prices of manufactured goods was downward from the latter part of the nineteenth century to the eve of the Second World War; at the end of this period, a given volume of exports of primary commodities would pay, on the average, for only 60 per cent of the quantity of manufactured goods that it could buy at the beginning of the period."³ Thus the developing countries have been facing an uphill task in augmenting their export earnings. Their ability to pay for imported articles has been declining. The important point, in this context, is to recognize the fact that the relative strength of primary producers has been reduced. "Whatever the reason may be," Youngil Lim has rightly stated, "the deteriorating long-term commodity terms of trade against primary goods means a decreasing amount of imports for a given amount of exported primary goods. The 'inability' of productive factors to get out of the export

³Gerald M. Meier and Robert E. Bladwin, *Economic Development*, John Wiley & Sons, London, 1957, p. 235.

industries, coupled with the deteriorating terms of trade, so the argument goes, results in the slow pace of development."⁴

Pockets of Development

Historically, many of the backward regions got their first taste of industrialization as a result of overseas investors developing export sector of the economy. This had resulted into pockets of development whilst the general economy remained backward. For this reason, many of the underdeveloped countries have been characterized by the term "Foreign Enclave of an Export Sector." This term implied that certain export sectors of the country, which otherwise remained backward, were developed with imported labour as well as with imported capital. This tendency, as Professor Singer has pointed out, did not very much contribute to the overall development of the region. The production facilities for exports provided to these underdeveloped countries never became a part of the internal economic structure of the countries themselves, except in the purely geographical and physical sense.⁵ This has been so because the multiplier effect generated by such investments does not take place in the borrowing country, rather it takes place in the metropolitan country from which the investment has been forthcoming. The foreign investors or the foreign employees at these "enclaves" did not spend their increased income in the exporting country because their propensity to consume locally had been almost negligible; the added export income generated neither expansion of income nor of employment in the rest of the export economy. Within the export economy, the foreign trade multiplier for their increased income was zero; it was the country to which they remitted these added earnings

⁴Youngil Lim, "Trade and Growth, The Case of Ceylon," *Economic Development and Cultural Change*, Chicago, January 1968, p. 246.

⁵H. W. Singer, "The Distribution of Gains between Investing and Borrowing Countries," *American Economic Review*, May 1950, pp. 477-9.

that the foreign trade multiplier operated.⁶

Youngil Lim has examined this contention with regard to Ceylon, but he has come to a negative conclusion in this regard.⁷ Foreign investment in an exporting country does not necessarily establish "foreign enclaves." Nonetheless, such investments do create difficult problems. Such economic activities are generally established with a view to assisting industries established elsewhere and they are not related to the programmes of industrialization of exporting countries. They often lead to shrinkage of foreign investment. Instances have come to notice that the investors in tea and coffee plantations in India have transferred their investments to other countries bringing serious dislocation and ruin to several important sectors of the economy which could have been important foreign exchange earners. Evidently, the exports of a developing country present problems which are not necessarily economic in character. Nevertheless, these problems have to be tackled effectively for the viability of the industrial programmes of development.

Shrinking Market Opportunities

Moreover, the industrially advanced countries do not readily provide market opportunity to the developing countries. When the underdeveloped regions begin industrial development, they need market for the sale of their semi-processed and fully manufactured items. The primary raw materials which so far they have been exporting to advanced countries are processed locally, and in the manufactured form—either fully or partially—they could be made available to the erstwhile importing countries. Competition against such articles in advanced countries has been severe. These articles, in many cases, do not have the same standard of perfection as those fabricated in advanced countries. And, there is natural reluctance against

⁶J. V. Levin, *The Export Economies, Their Pattern of Development in Historical Perspective*, Harvard University Press, Cambridge, U.S.A., 1960, p. 197.

⁷Youngil, Lim, *op. cit.*

new entrants into the market. Home market does not provide expanding opportunity for the consumption of such sophisticated articles, and even if it exists it has to be restrained. Apart from psychological and political resistance, tariffs, quotas and other trade barriers are also imposed in order to eliminate free entry of such goods in developed markets. These create problems. Often unhealthy competition arises among the developing countries themselves. Thus, economic, political, psychological conditions and imperfections of international trade create problems which the underdeveloped countries have to surmount.

Preconditions of Success

We have already discussed in an earlier chapter the effect of devaluation on increasing the level of exports. From that discussion it may be clear that the export promotion measures depend upon various domestic and international factors. Both the contracting parties have to create favourable conditions for the success of these measures. The first condition in this context is to augment the level of national output. This has to take place without any significant increase in the propensity to absorption. Only under these conditions, the exportable surplus in the country can increase. In order to increase national income, which in fact is a function of capital stock and productivity of the factors, both of these should increase. The rate of savings has an important contribution to make in this regard: investment in a community depends upon the level of income multiplied by the average rate of savings. From these conditions, it can be seen that the rate of savings, the level of absorption as well as the productivity of capital have important influence in generating exportable surplus. The output-capital ratio would reflect the intensity of utilization and the operational efficiency of the available capital stock. If the different factors of production are inefficient and the workers are more interested in demanding need-based wages than in raising their efficiency, the resulting output-capital ratio would naturally be unfavourable: in international market such

commodities would find immense difficulty in competing with the output from other countries.

Equilibrium Level of Exports

From the Fundamental Identity mentioned in the previous chapter, it can be deduced that

$$(Y+M)-(C+I+G)=X$$

which implies that the increase in the level of exports would depend upon the increase in the total output ($Y+M$) and decrease in the level of absorption, namely, ($C+I+G$). During the period of rapid industrialization of an underdeveloped country C , I as well as G would increase very rapidly. Only when the rate of growth in absorption is less than the rate of growth of national output, the rate of growth of exports can increase. This indicates the importance of consumption, investment, imports and exports. Kenneth E. Boulding has clearly described the relationship existing between these functions.⁸

Kenneth E. Boulding makes it clear, at the very outset of his analysis that imports (M) add to total stock of goods available within the country, and that exports subtract from this stock. Therefore, in the above identity, inclusion of imports with total output of the economy, and of exports with other items of expenditure such as C , I , and G is justified. According to Boulding, "imports have the same effect as production and exports as consumption" and, therefore, he has formulated the Fundamental Identity as follows:

$$A=(P+M)-(C+X)$$

where A is total accumulation, or additions to stock, P is production, C consumption, M imports, and X exports. On the basis of this identity, Boulding has stated the "export identity" as follows:

$$X=P-(C+A)+M$$

In order to construct an equilibrium model, Boulding states the

⁸Kenneth E. Boulding, *Economic Analysis*, pp. 394-8.

necessity of postulating four behaviour equations, namely,

- (i) Consumption Function, $C = F_c(P)$
- (ii) Import Function, $M = F_m(P)$
- (iii) Export Function, $X = F_x(P)$
- (iv) Investment Function, $A = F_a(P)$

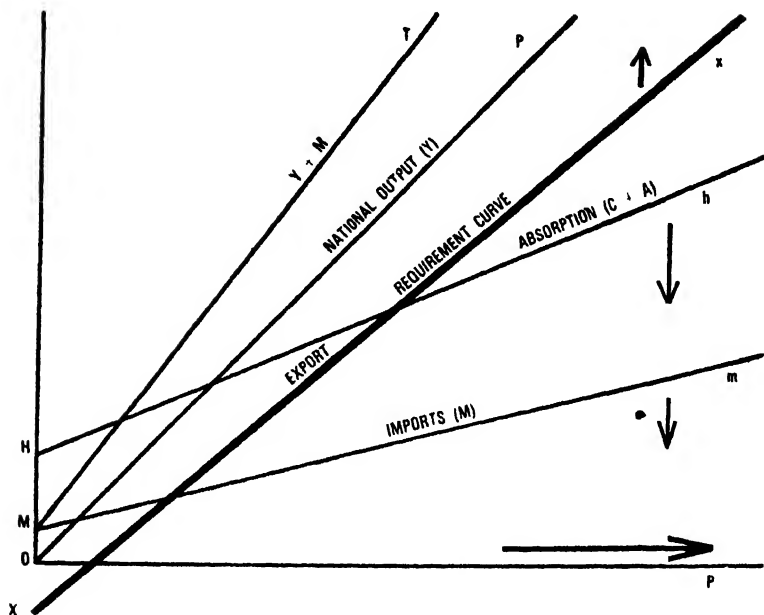
These assumptions are not necessarily very realistic, but they do indicate the basic relationship. The first three equations assume that there are unique levels of consumption, imports and exports for every level of output as given by the consumption, import and export functions respectively. The fourth equation postulates that for every level of production there is a desired level of internal accumulation of real goods as given by investment function. As the level of income Y (or, $O.pr$, where O is total output and pr is the average price level, or P which is total production in money terms) is a function of I/α where α is the average rate of savings, and I total investment, it is suggested that Y and C are intimately connected even with investment expenditure. Therefore, there are only three autonomous variables namely, P , C , and M which are the main determinants of changes in exports. This implies that the level of consumption expenditures both in the personal and the governmental sectors, must be low, the propensity of such expenditures also low in order to yield a higher value of $1/\alpha$ and the levels of P or Y should be high so as to yield maximum I . With increasing productivity of capital, it is expected that the level of exports would be considerably high.

Export Requirement Curve

The various factors involved in export promotion measures can be graphically indicated as shown on p. 148.

The diagram represents in a simple way the various factors involved. OP represents the level of output, Mm represents the level of imports. MT represents the total availability of goods, i.e. output plus imports, Hh is the Home Absorption Curve signifying the various levels of consumption and investment expenditures in the community. The equilibrium level of exports, or

RELATIONSHIP BETWEEN
EXPORT REQUIREMENT CURVE, NATIONAL OUTPUT,
IMPORTS AND ABSORPTION



the Export Requirement Curve X indicates the different levels of exports which would be in equilibrium at the different levels of output, Home Absorption, etc. In order to raise this level of exports, it would be necessary to raise the level of output; the level of imports for strategic reasons will have to be judiciously rationed in order to see that the productivity of the capital stock did not suffer. Consumption and investment expenditures are intimately connected. By reducing the propensity to consume, it would be possible to reduce Home Absorption though Investment expenditure may be maintained at the previous level. When the availability of exportable surplus has to increase, these factors will have to be carefully managed.

In the above identity, Y and M are considered together to find out the equilibrium level of exports, but $M = -Fm(P)$

suggests that a larger number of variables influencing Production Function of any economy, would affect, directly and indirectly, the imports. The export promotion measures of a developing country would also require that the industrialized countries adapted their production programmes in such a way that they helped the growing nations. This involves a careful examination of the pattern of production, structure and technology involved, consumption propensities and such other variables. Efforts should be made to provide greater opportunity for the utilization and importation of raw materials, semi-processed and manufactured articles from developing countries. Import control measures and trade barriers will also have to be liberalized.

Another factor which complicates this problem is the competition between different exporting countries themselves. Presently, the exports are not merely a function of comparative cost. Political and economic compulsions necessitate that a large number of developing countries exported at lower than domestic prices. Export promotion measures are often carried out by these countries with vengeance: subsidies, rebates, and concessions even when the domestic economy has been unable to bear their heavy burden are granted even at the risk of starving the indigenous population. In order to price out other competitors, it has become vogue to offer preferential export prices to foreign importers. Even the importing countries are not necessarily guided by the cheapest price offers. Blocification based on political, communal, and regional considerations often damages the export prospects of an earnest and struggling country. The export promotion measures of an underdeveloped country have to face many different kinds of problems, some arising from internal conditions and others from economic, political, social, and similar other factors prevailing in industrialized countries. It is only by studying the different problems facing a developing country that the various complexities of export promotion measures become apparent.

Stagnating Indian Exports

Indian exports provide a glaring instance of underdevelopment or stagnation despite much encouragement given to this sector. The fact that this has been so for the last twenty years or so suggests that there must be some fundamental weakness in the Indian economy, otherwise, the situation must have improved. But evidently there has been no improvement of any significance.

In 1948-49, the Indian exports were valued at Rs 450.7 crores which increased to Rs 732.9 crores in 1951-52, since then the exports began declining till 1953-54 when they amounted to Rs 530.5 crores. After this period, the exports rose to Rs 805.7 crores in 1965-66 and Rs 1094.9 crores in 1966-67. This increase has, however, not been commensurate either with the rate of increase in national income or with the rate of growth of world exports. Table I shows that Indian exports accounted for 5.3 per cent of national income in 1948-49 rising to 7.4 per cent in 1951-52 but this rise was caused by the Korean war stock piling programme. Following this period, the Indian exports as a proportion of national income have been declining, reaching a proportion of 4 per cent in 1965-66. In 1966-67, though the rupee equivalent of Indian exports accounted for Rs 1,094.9 crores, yet as a proportion of national income it amounted to 4.7 per cent only.

Similarly, stagnation is noticeable even when Indian exports are considered as a percentage of world trade. In 1948, the Indian exports accounted for 2.35 per cent of world exports, which declined to 1.85 per cent in 1950; it rose to 1.95 per cent in 1951, after which the proportion has been declining almost every year, reaching a proportion of 0.75 per cent in 1967. Evidently, these data suggest stagnation, the causes for which must be critically examined in order to work out an effective programme for the country's export promotion.

Wrong Things to Wrong Places

Many economists have recently discussed the problem of stag-

TABLE 1
INDIAN EXPORTS AS A PERCENTAGE OF NATIONAL
INCOME AND WORLD EXPORTS

<i>Year</i>	<i>Exports as percentage of</i>	
	<i>National Income</i>	<i>World Exports</i>
1948-49	5.3	2.35
1949-50	5.6	2.16
1950-51	6.3	1.85
1951-52	7.4	1.95
1952-53	5.9	1.63
1953-54	5.1	1.38
1954-55	6.2	1.40
1955-56	6.0	1.36
1956-57	5.3	1.24
1957-58	4.9	1.22
1958-59	4.6	1.12
1959-60	4.9	1.12
1960-61	4.7	1.02
1961-62	4.6	1.02
1962-63	4.6	0.98
1963-64	4.6	1.05
1964-65	4.0	1.00
1965-66	4.0	0.90
1966-67	4.7	0.78
1967-68	4.1	0.75

SOURCES : Economic Surveys of Government of India, New Delhi; International Financial Statistics, I. M. F.*

nation in Indian exports. Surendra J. Patel has examined the export performance of India over the last few decades. He has stated that "the quantum of world exports has increased by more than two-thirds in the course of the last two decades, but the combined volume of exports from Burma, Ceylon, India, and Pakistan is now actually lower by a tenth. Thus the vast expansion in world trade over the last three decades has simply

*Economic Surveys give data for the financial year, i.e. from April to March, which has been the basis for national income, whereas world exports refer to calendar year.

by-passed the Indian sub-continent.”¹⁰ The stagnation in the overall volume of exports (the increase in the volume of tea being offset by the decline in others) has continued despite strenuous efforts at export promotion and a preparedness to export even if it meant restriction on, or the very limited increases in domestic supplies, Patel has further commented.

The main causes for this situation, according to Patel, have been related to direction of trade and commodity composition of exports. The stagnation of India's exports is “not due to the fact that India was dealing with trade partners whose imports were stationary or declining. Indian exports have simply failed to share in an otherwise expanding market.”¹¹ Broadly speaking, the changes in the direction of India's foreign trade have remained minor over the last few decades. The industrialized countries, which have been the main trade partners of India, have increased the volume of their exports* but have reduced the volume of their imports from this country. Pre-industrialized countries provided opportunities for Indian exports to grow in the early post-war years when exports from European countries had not fully recovered. But, it was only a short term phenomenon. Presently, this kind of Indian exports is only a little higher than in the late twenties. India's trade with centrally planned economies though has recently been increasing, accounts for very little.

Surendra J. Patel has indicated that in the volume of imports from all primary producing countries into Western Europe, the share of the United States and Canada has nearly trebled between 1928 and 1956. The imports from India, Pakistan, Burma and Ceylon however have increased very slightly. “Since prices during this period have risen considerably, it is obvious that the volume of imports from these countries into the industrialized countries, India's traditional trade partners, has fallen markedly.”¹² This has occurred due to a “fundamental shift that has taken place

¹⁰Surendra J. Patel, “Export Prospects and Economic Growth India,” *The Economic Journal*, London, September 1958, p. 491.

¹¹*Ibid.*, p. 493.

¹²*Ibid.*

in the import demand of the industrial countries." During the course of the nineteenth century and the first quarter of the twentieth century, the bulk of the imports—more than 90 per cent—of the industrial countries from the primary producers consisted of agricultural products. These commodities during recent years have been superseded by petroleum and mineral products. Among the agricultural exports themselves, the decline has been much sharper for raw materials than for food products.

While analyzing the commodity composition of exports, Surendra J. Patel has explained that the structural shift in the import demand of the industrialized countries is illustrated by the performance of the commodities that predominate in India's exports. Analyzing the factors influencing jute manufactures, tea, cotton textiles and groundnut oil, he has concluded that "in all cases domestic supply has increased and can be increased even more over a period of time if there was an adequate demand. As far as exports of minerals and ores (mica, manganese and iron ores) are concerned, export demand rather ability to export is again the decisive factor."¹³ Finally, Patel has concluded that

reason for the stagnation in India's export trade may be simply expressed. India has been trying to sell more of the wrong things to the wrong places. The efforts at export promotion can no doubt be increased, and high pressure salesmanship in export markets may increase somewhat the exports to some destinations. The main fact, nonetheless, remains that offering more of the same things to the same people, who no longer want more of them, lies at the basis of a remarkable poor performance in the export trade over the last three decades.¹⁴

New Competition and Exports in Slowly Expanding Items

Sir Donald MacDougall has also analyzed the Indian

¹³*Ibid.*, p. 496.

¹⁴*Ibid.*, p. 497.

exports in relation to India's Balance of Payments and has stated that "India's exports have been stagnant during the last ten years of at least in value, though there has been some upward trend in quantity."¹⁵ He has advanced two broad reasons for this underdevelopment.

Firstly, in certain categories, primarily those which have been India's traditional exports, new competitors have been entering the market. In jute manufactures, for example, Pakistan has entered the world export market, and Thailand has entered that for lac. In tea, East Africa and Ceylon have been increasing their share of the UK market at India's expense. India's share in the world market for manganese ore has fallen; new competitors have been entering the field. In groundnut oil, where once she had a substantial share, her exports have now virtually dried up.

Secondly, India has failed to take up countervailing measures. She has failed to reorganize her economy in order to take advantage of those sectors of the world trade which have been developing faster. Sir Donald MacDougall has stated that "the more important reason, however, why India's exports have fared so much worse than world exports as a whole is that they depend rather heavily on items where world trade is expanding only slowly, if at all."¹⁶ India's traditional exports consist nearly one-half in tea, cotton textiles, and jute but the world trade in these items is not likely to expand rapidly in future, "barring a striking increase in imports by the Soviet blocks." Moreover, India's share in tea and jute manufactures is already high and any attempt to expand markedly her "quite substantial share in cotton textiles would be likely to provoke restrictive measures abroad."

But, Sir Donald MacDougall hopes that India should be able to expand even outside the field of newer manufactures, as in the case of iron ore, coffee, fish, vegetable oils and, in the field

¹⁵Sir Donald MacDougall, "India's Balance of Payments", *The Bulletin of the Institute of Statistics*. Oxford, May 1961, p. 161.

¹⁶*Ibid.*

of invisible exports such as tourism. "These are items where world trade should expand rapidly, or where India's share is small and could be raised substantially. There is also a good number of other quite promising items."¹⁷ Nonetheless, according to Sir Donald, it is essential for India to make substantial contribution to newer manufactures. Taking account of all these considerations, he has concluded that "an almost revolutionary change will be required in the structure of India's export trade. When this has become more heavily weighted in favour of products where world trade is growing fast, a rapid expansion of her exports will become less difficult."¹⁸

About the magnitude of the task involved, Sir Donald has finally stated, "I must confess that India's export task looks extremely formidable but I do not think it need be a matter of despair."¹⁹

*Inverse Price-Export Relationship and
Conflicting Government Policies*

In a detailed analysis, Dr Benjamin I. Cohen has emphasized that the India's loss in expanding world markets has been caused by an increase in the price of Indian exports relative to her competitors' prices which has been accentuated due to the "policies adopted by the Indian Government to achieve goals which had a higher priority than export promotion."²⁰ Concentrating on 16 commodities which accounted for 67 per cent in 1957 and 76 per cent in 1950 and 1954 of the total volume of all Indian exports, Dr Cohen has concluded that the export of all these commodities in 1960 was higher than that of 1948, but India has maintained continuous increase in the share of total world exports only as far as exports of iron ores are concerned. Dr Cohen has stated:

¹⁷*Ibid.* ¹⁸*Ibid.*

¹⁹*Ibid.*, pp. 161-2.

²⁰Benjamin I. Cohen, "The Stagnation of Indian Exports, 1951-61." *Quarterly Journal of Economics*, Harvard University, Mass., Vol. 78, No. 4, November 1964, pp. 605-6.

For some commodities—tea, cotton cloth, jute manufactures, peanut oil, leather and manganese ore—India's share of total world exports has fallen over most of the decade. For other commodities—cotton yarn, peanuts, hides and skins, mica, black pepper, and raw tobacco—India's share of world exports has fluctuated around a mean value which is below its post-1948 peak. For the remaining commodities—cashew kernels, raw cotton and raw wool—India's share of world exports has simply fluctuated around a mean value with little evidence of any trend ²¹

These indicate that the Indian export promotion measures though have been bearing some fruits in augmenting her aggregate exports yet have been inadequate in maintaining her relative share in world exports. On an examination of the market response to different prices, Dr Cohen has statistically confirmed a positive relationship between India's relative export prices and her relative export quantities. According to Dr Cohen, empirical evidence suggests that variations in prices of the Indian exports relative to those of her competitors do influence the quantities of her exports. This relationship, however, "does not preclude a shift in the demand curve for Indian exports which would affect domestic Indian prices, and a greater upward shift in the demand curve for Indian export earnings."²²

The relationship postulated, however, did not suggest an upward shift over time in the supply curve of Indian exports but according to Dr Cohen, some of the policies of the Indian Government have contributed to such an upward shift in the supply curve. While commenting upon the role of government in augmenting Indian exports of cotton textiles, Dr Cohen has stated:

While developed countries frequently view export promotion as a means of increasing labour employment, export pro-

²¹*Ibid.*

²²*Ibid.*, p. 611.

motion of Indian cotton cloth conflicted with providing employment opportunities in the mills and decentralized sector (handlooms and powerlooms); export promotion was also subordinated to stabilizing the domestic price of cotton cloth. To protect the workers in the decentralized sector, a ceiling has been placed on the mills' production for the domestic market. Attempts to reduce mill production costs by installing automatic looms have been resisted by both textile labour unions and supporters of the handloom industry.²³

Similar conflicting policy decisions have even encouraged the emergence of Pakistani jute industry. Dr Benjamin I. Cohen has indicated that the revenue considerations of the Government of India which led it to maintain export duties on jute goods through mid-1955 presumably encouraged the development of Pakistan's jute industry. Furthermore, he expected that the Indian Government's reluctance to subsidize jute goods in the long-run when the Pakistani capacity to produce jute goods expanded and which seemed to expand faster than world demand, "India will continue to lose her export markets unless she matches--or threatens to match--Pakistan's export subsidy."²⁴

Even with regard to manganese ore, the compromise formula evolved by the Indian Government between export promotion on the one hand and conserving ore deposits, subsidizing small mines, acquiring revenue, and curtailing under invoicing of exports on the other, has already induced foreign buyers to invest heavily in developing new mines in Africa and South America. These new mines have begun giving India increasingly severe competition in the United States and the United Kingdom. The trend, however, started with the apprehension that the Indian deposits, then estimated at 15-20 million tons, have been fast depleting. This fear was, later on, found misleading because the new geological surveys in 1962 indicated the reserves to be around 100 million tons. But, the

²³*Ibid.*, p. 613.

²⁴*Ibid.*, p. 615.

new mines have already been opened elsewhere and the Indian supremacy has been challenged. India's share of the volume of world exports of manganese ore which fell from 33 per cent in 1953 to 18 per cent in 1960 would in near future may drastically go further down. There is also some evidence that the activities of the State Trading Corporation have harmed Indian exports of manganese ore since its inception in mid-1956.²⁵

Absence of any Strong Political Group

Another significant feature of the export sector of the Indian economy which Benjamin I. Cohen considers vital has been the absence of any strong political group, excepting the combination of new jute growers and producers of jute goods. Absence of any such vested interest in export promotion has characterized absence of aggressive export promotion measure. Most of India's traditional exports are produced mainly in only a small part of the country: Tea (north, east, and south India), jute goods (West Bengal), cotton textiles (Bombay), short-staple raw cotton (Punjab and Maharashtra), peanut oil (Gujarat and Maharashtra), Leather (Madras) and manganese ore (east-west belt through central India). So it is politically difficult to ask for national sacrifices in order to aid the export of these commodities.²⁶

Conflicting Goals

From such detailed discussions, Dr Benjamin I. Cohen has attempted to show that the objective of export promotion has conflicted with other economic goals. Such social objectives as maintaining short-term labour employment, encouraging small-scale producers, besides increasing flow of foreign aid, control of imports and augmenting government revenues, have affected production costs and domestic demand so as to raise the supply price for Indian exports. This has damaged the relative position of Indian exports in view of the fact that "India's share of her export markets of her traditional exports was inversely related

²⁵*Ibid.*, p. 616.

²⁶*Ibid.*, p. 617.

to the price of her exports relative to those of her competitors.²⁷

Complex Nature of the Problem

Problems of export promotion are indeed very complicated. It would be erroneous to attribute any single cause for the development or otherwise of the entire gamut of export items. Different commodities at different times acquire different degrees of significance, and wherever those items are available, those places accordingly get into prominence. It is therefore appropriate that the steps for activating the export sector should be harmonized with the demand for different commodities arising during different periods in different countries.

Even the growth rate for different export items is not significant by itself: it is to be related to the general readiness of the exporting countries to adjust with the shifting conditions of the world trade reflecting changes in the industrializing process of the various countries. Before the discovery of coal, countries with huge mineral deposits were of no consequences, whereas after the discovery of mineral oil if any country with mineral oil deposits failed to exploit them, the economy of that country could be considered stagnant. In fact, the reluctance to take advantage of the geographical conditions and technological improvements and to remove rigidities against optimization of the resources may ultimately be ruinous to the country. From this standpoint, it is necessary to examine the pattern of Indian exports to see whether the anxiety to attain short-term exchange maximization objective has beclouded the long-term basic problems.

High Concentration of a few Commodities

Certain significant features of the Indian export pattern may be seen in Table 2. Sixteen commodities grouped in four categories have accounted for about four-fifths of the total exports: in 1950-51, they accounted for 78.5 per cent and in 1966-67, 80.7 per cent; the highest proportion was attained in

²⁷*Ibid.*

TABLE 2
SHARE OF DIFFERENT EXPORT GROUPS IN
TOTAL EXPORTS

(1950-51 to 1966-67)

Year	Total exports (US Million \$)	Agricul- tural pro- ducts	In percentage		Machinery
			Agro-based manufatures	Mineral products	
1950-51	1,261.8	24.6	49.9	3.1	0.9
1951-52	1,539.0	23.5	51.2	4.1	1.0
1952-53	1,212.1	28.2	40.8	6.0	2.2
1953-54	1,114.5	30.5	43.1	7.2	1.8
1954-55	1,244.3	35.7	38.8	4.0	1.3
1955-56	1,252.7	32.1	37.2	4.3	1.5
1956-57	1,269.5	35.2	37.1	5.6	1.2
1957-58	1,178.8	31.1	37.9	9.0	1.4
1958-59	1,220.0	36.8	34.0	5.7	1.3
1959-60	1,344.5	33.9	36.3	5.7	1.6
1960-61	1,386.7	31.8	36.9	6.2	2.4
1961-62	1,427.6	34.6	36.3	8.2	2.0
1962-63	1,499.2	35.7	35.2	7.5	2.3
1963-64	1,687.4	33.9	34.3	6.8	3.8
1964-65	1,714.5	34.8	35.0	7.4	3.9
1965-66	1,692.5	31.9	37.4	8.0	4.9
1966-67	1,557.9	30.8	37.5	8.4	4.0

SOURCES : *Monthly Statistics of Foreign Trade*, Department of Commercial Intelligence and Statistics, Bombay.

1953-54 (82.6 per cent) and the lowest in 1955-56 (75.1 per cent). This implies a very high degree of concentration suggesting that decline in the demand for even a few commodities could seriously upset the balance. And indeed, it has happened so on various occasions.

Stationariness of Relative Proportions

Second main feature of the Indian exports has been almost stationariness of the proportion of (i) agricultural products including tea, oil cakes, cashew kernel, tobacco (unmanufactured), cotton (raw and waste), coffee and spices, and (ii) agro-based manufactures consisting of jute

manufactures, cotton manufactures, leather goods, and coir products. The share of these items in the total exports even on the basis of three-yearly moving-averages shows that the proportion has been fluctuating around 70 per cent of the total: the period 1950-57, the proportion was a little higher, around 72.5 per cent and after 1962-63, it has been around 69 per cent. From this one is likely to infer that the inter-commodity variation in exports during the last 18 years has been almost negligible.

This impression is, however, misleading. For example, coffee, oil-cakes, and sugar did not enter the export trade in 1950-51 in any substantial magnitude, but by 1958-59 these three commodities taken together accounted for Rs 22.7 crores as against merely Rs 1.7 crores in 1950-51, whereas cotton (raw and waste), cotton manufactures and spices have been losing ground till recently: the combined total of these items which amounted to Rs 181.8 crores in 1950-51 had declined to Rs. 96.6 crores in 1964-65 and in 1966-67 also, they accounted for only Rs 122.2 crores. But, the variations in relative proportion of the different commodities included in the two groups have not altered the relative positions of these groups.

The exports of agricultural products have shown significant growth: their value has increased from Rs 148.2 crores in 1950-51 to Rs 337.2 crores in 1966-67 showing an increase of 127 per cent in 16-year period. As a proportion of total exports, this category increased its share from 24.6 per cent in 1950-51 to 30.8 per cent in 1966-67. Exports of these commodities cannot therefore be considered as stagnant. The main reason for this improvement has been the favourable geographical conditions for the cultivation of these agricultural products. Excepting tobacco, almost all the articles included in this group have shown special preference for tropical climate with high temperature having heavy precipitation and fertile soil. None of these commodities can be satisfactorily cultivated in temperate climate.

The United States and the USSR have been exceptions.

Tea requires precipitation between 60" and 100" and temperature between 85°F and 95°F during summer and never below 60°F. It is this unique combination of the right amount of rainfall and temperature in relation to humidity, specially on fertile hilly land that makes the production of good quality tea possible. Hot rainy summer and cool dry winter on a high elevation favour coffee cultivation. The rainy season with precipitation between 40" and 70" and temperature between 60°F and 80°F and winter months with temperature between 55 F and 65 F provide the best conditions for coffee provided the soil is red clay loam specially derived from lava and ashes with high proportion of potash and phosphorus. In fact, every other product such as cashew kernel, cotton, oilseeds, and spices which form the bulk of Indian exports is a speciality of the countries having tropical and equatorial types of climate rich with fertile soil.

Cotton requires abundant water supply, preferably canal irrigation and the soil of the dark clay type. Presently, 70 per cent of cotton cultivation has been limited to the United States (31 per cent), China Mainland (14 per cent), the USSR (14 per cent), India (9 per cent), and Pakistan (3 per cent). Cotton fibres produced in India are mostly of the short and medium staple suitable only for low grades of cloth and it has therefore no competition with better varieties grown elsewhere. Cashew kernel also grows in hot climate and so does oilseeds from which oil cakes are extracted.

As far as tobacco is concerned, it is one of those items which are produced and consumed in nearly every country, but at the same time, few commercial crops are more sensitive to changes in weather and differences in soil than the tobacco plant. The amount and character of precipitation, humidity, temperature and the quality of soil affect the thickness, elasticity, tenure, colour, size, perfection and weight of leaf and the flavour of tobacco. The most appropriate climatic condition for tobacco cultivation is temperature between 65°F and 80°F,

rainfall between 40" and 50" and relatively high humidity; soil should be light kind of loam or black cotton type with potassium and iron alongwith phosphorus. Sandy loam of a light variety is the best kind of soil that tobacco chooses to grow on. Therefore, the type of tobacco exported from India is distinct from that grown in other parts of the world.

These geographical and geological conditions for the cultivation of agricultural products indicated above limit the area where they could be economically grown. Consequently, elasticity of world supply of these items is very low; the growth in demand for these items influences the intensity of cultivation and extension of the same on marginal areas. Demand for most of the items such as coffee and cashew kernel is highly income elastic, whereas others have entered the pattern of consumption as inevitable articles of consumption. Total demand originating in advanced countries for these items has been so substantial that the expansion in their exports becomes a natural phenomenon. One need not find any other special reason for their growth, and a large proportion of gain obtained by India with regard to agricultural products should be attributed to this factor.

As far as agro-based industries are concerned, they have been well established in India. In early days, they could obtain abundant supply of basic materials such as jute, cotton, hides and skins, and coir for processing them into higher goods. These also have been the items which are specially suitable for cultivation in the tropical type of climate. During the last few years, competition from other adjoining countries having identical conditions has affected their production in India. In some cases, as in cotton textiles industry, the conflicting policy decisions of the Government of India, to which Dr Cohen has referred to, have been the main causes for the deterioration in Indian exports. It is the agro-based industries which seriously face the challenge of competition from other developing countries, specially Pakistan.

The third major group of exports from India consists of

mineral deposits, mainly, iron ores, manganese ores, and mica. Exports of these ores have increased from Rs 18.2 crores in 1950-51 to Rs 92.0 crores in 1966-67. As a proportion of total Indian exports, the share of this group amounted to 3.1 per cent in 1950-51 and 8.4 per cent in 1966-67. Fluctuations in the volume of annual exports of this group have been significant, mainly due to the irregular demand for manganese ores: in 1952-54, Rs 46.2 crores worth of manganese ores were exported as against Rs 23.7 crores during 1950-52 and Rs 23.6 crores in 1954-56. In 1957-58 Rs 29.7 crores worth of manganese ores were exported, whereas in 1956-57, they were only of the order of Rs 16.0 crores and in 1958-59, amounting to Rs 13.6 crores. Mineral deposits have been ordained by nature, and mining operations only indicate the exploitation of such natural gifts. Human ingenuity cannot augment the supply of these deposits.

Although several countries of the world have few important mining districts, the major areas have been mainly three: one of these is North American region extending from Alaska and North Central Canada to Southern Mexico; the second major mining area is in Eurasia, from Western United Kingdom and the Iberian Peninsula to East Central Siberia; and the third major mining area has been Southern Eastern Asia, including India, Mainland China, Japan, Malaya, and nearby islands. There are several other significant mining areas of the world, but these three chains give bountiful of mineral deposits, though certain special categories of deposits are available at certain other places too. India, Mainland China and Japan have coal, iron ores and a variety of other minerals. Malaya and Indonesia are outstanding in mining tin for export; India exports manganese; Indonesia exports petroleum. Special grade of mica is also a speciality of India.

Demand for mineral deposits depends on several conditions depending on their end-use. The development of electricals and electronics industries has increased the demand for mica. Manganese has the quality of hardening the steel particularly for

the manufacture of hardware. Demand for iron ore is very great due to general industrialization programme in underdeveloped as well as in developed countries. Because of specially suitable position of India in this regard, her exports of iron ores have increased substantially.

The impact of Indian economic development in augmenting the quantum of exports can be preceptible through the availability increase of machinery for the export purpose. This group consists of engineering goods, metal manufactures, electrical and other machinery items, transport equipment and other engineering goods. These items accounted for only Rs 5.4 crores of exports in 1950-51 which have gradually increased to Rs 44 crores in 1966-67 showing an eight-fold increase. As a proportion of total exports they have risen from 0.9 per cent in 1950-51 to 4.9 per cent in 1965-66, and they amounted to 4 per cent in 1966-67. But, it may be seen, that these items form only a small proportion of the total Indian exports.

From the above, it may be concluded that the expansion of Indian exports in categories other than machinery has been due to external and natural factors. Demand for mineral deposits as well as agricultural products has increased elsewhere due to rise in their national income which has changed the pattern of demand in favour of some of these goods as in the case of mica, manganese, ironore, cashew kernel, coffee, oil-cakes, and tobacco. Supply of such items can be possible only from a few other countries having identical geological and geographical conditions. The export potential of these countries with regard to the items exported from India has been restricted. But this situation may not continue for good, specially with the beginning of the development programmes in competing countries. Pakistan enjoying almost identical conditions has begun challenging Indian supremacy in several items. Development of new mines in some other areas has been threatening the monopolistic position of India with regard to mineral exports.

Changing Directions of Indian Exports

Changing direction of Indian exports would show that the

latest trend has not been very favourable. In 1950-51, Indian exports to other developing countries such as Pakistan, Burma, Ceylon, Kenya, Argentina, UAR, and Iran accounted for 16.5 per cent of her total exports which declined to 5.8 per cent in 1966-67. One is, therefore, likely to infer that India's traditional relationship with some of the important developing countries has been weakening. This decline has been attributed to political as well as economic causes. Because of their foreign exchange difficulties, many of them have restricted their imports; Ceylonization and Africanization of business houses have further disrupted the well-established Indian trading channels. Hostility with Pakistan has almost eliminated Indian exports to that country which in 1950-51 was very substantial accounting for 5 per cent of the total Indian exports. The industrialization programmes of other developing countries are not likely to provide an expanding market opportunity to the Indian goods. This is due to the fact that the developing countries in Asia and Africa having almost identical geographical and geological conditions produce competitive rather than complementary economic conditions.

It is noteworthy that the Indian exports to already industrialized countries have also shown a downward trend. The United States (19.2), the United Kingdom (23.3), Australia (5.1), Italy (2.5), Canada (2.3), West Germany (1.8), the Netherlands (1.6), Belgium (1.6), France (0.5.), and New Zealand (0.6) accounted for 58.5 per cent of the Indian exports in 1950-51 but by 1966-67, their share declined to 49.3 per cent. Exports to Japan have increased from 1.7 per cent in 1950-51 to 9.2 per cent in 1966-67 but it has been so due to special circumstances relating to iron ore exports which have expanded substantially during the recent years. In this context it may be relevant to indicate that a decline of 9.2 per cent of exports to such advanced countries with great market possibilities has been counterbalanced over the period by an increase exports to the USSR. Indian exports to centrally directed socialist countries of Europe have expanded

from Rs 8.8 crores in 1951-52 to Rs 211.0 crores in 1966-67, of which exports to the USSR accounted for Rs 6.9 crores in 1951-52 and Rs 116.3 crores in 1966-67. This shift, apparently heartening, conceals difficult conditions. Expansion of this magnitude in Indian exports has been made possible at the cost of Indian exports to other developed West European countries where the market is free and expanding and which provides free foreign exchange vitally necessary for the Indian imports. On the other hand, the Rupee Payment Agreements do not provide free foreign exchange whilst drawing out valuable Indian articles, which are not necessarily exportable surpluses. Moreover, the possibility of market expansion in such countries apart from being rigidly inelastic, depends primarily on political decisions of their governments. Considering these factors, the exports to these countries may not be considered viable.

Countrywise Concentration of Exports

Thirdly, Indian exports as it would be seen from Table 3 are highly concentrated in only a few countries. Eight countries, namely, the USA, the UK, the USSR, Japan, UAR, Canada, West Germany, and Australia accounted for 54.6 per cent of Indian exports in 1950-51 which even in 1966-67 remained at 55.4 per cent. Such concentrations conceal possibility of political pressurization. Moreover, aggressive export strategy adopted by other competing countries might eliminate India from these countries. In fact, that is what is happening presently. This would become clearer when the trend and prospects of different commodities are examined. At the moment, however, it may be concluded that the developmental activities of India have not enabled her to open out substantial new markets for her exports.

Main Trends in Commodity Export

Now, we shall examine the main trends in some important export items. Six items, namely, jute manufactures, tea, cotton textiles, leather goods, iron ores, and cashew kernels

TABLE 3
CHANGING DIRECTION OF INDIAN EXPORTS

<i>Countries</i>	<i>(Percentages)</i>			
	<i>1966-67</i>	<i>1960-61</i>	<i>1955-56</i>	<i>1950-51</i>
United States	18.8	16.0	14.6	19.2
United Kingdom	17.3	26.9	27.8	23.3
USSR	10.7	4.5	0.5	0.2
Japan	9.2	5.5	5.1	1.7
UAR	2.3	2.1	1.6	1.0
Canada	2.7	2.7	2.3	2.3
West Germany	2.2	3.1	2.5	1.8
Australia	2.2	3.5	4.2	5.1
Total	55.4	64.3	58.6	54.6
Others	44.6	35.7	41.4	45.4

account for three-fifths of the total Indian exports. A study of the special circumstances relating to these items would show how difficult is the problem of expanding Indian exports.

Jute Manufactures

Jute manufactures accounted for 18.9 per cent of total Indian exports in 1950-51, 19.8 per cent in 1955-56, 20.5 per cent in 1960-61, 22.7 per cent in 1965-66, and 21.5 per cent in 1966-67. In 1951-52, 795,000 tons of jute manufactures were exported from India which increased to 860,000 tons in 1955-56, declined to 764,000 tons in 1960-61 after which they have been gradually increasing till 1963-64 when they amounted to 918,000 tons. During 1964-65, only 907,000 tons of jute goods could be exported; in 1965-66 the amount declined to 831,000 tons. Indian exports of sacking to Africa declined from 81,400 tonnes in 1964-65 to 55,400 tonnes in 1965-66 and 49,800 tonnes during 1966-67. The off-take of sacking even by the United Kingdom, the Far East and Argentina has not been satisfactory. Evidently, India will have to seriously consider her jute trade in order to maintain her relative position as well as absolute quantum in world trade of the item.

Indian share in the world trade in jute goods has gone down from 83 per cent in 1957 to 58.5 per cent in 1966.

The market for jute goods, if not shrinking, has not been expanding either. The increasing tempo of industrialization and the expanding volume of world trade should have ordinarily led to increased demand for jute manufactures. This trend, however, has slowed down due to increasing efficiency in mechanical bulk handling and emergence of jute substitutes. During recent years many kinds of jute substitutes such as polypropylene yarns, cloth and bags have been cutting into jute market. But, new uses of jute have also been opening up. The development of a new light weight woolpack developed by the Indian jute industry might effectively face the challenge posed by the polypropylene Japanese pack. The use of jute netting for the protection of soil erosion and evolution of a bag suitable for packing sugar, fertilizer, cement as well as talcum powder might be helpful. Jute is making inroads even into the fashion trade: various uses to which jute can be put to as in the case of hats, dresses, shower-proof coats, shoes, handbags, lipster belts and rope, solid slippers and such other items indicate the possible avenues for new undertakings which might add to the traditional demand for jute. Jute is now considered as a decorative fabric; carpet backing has already established market. As a result of such upward shift in demand for jute goods, there is no danger. in spite of the emergence of substitutes and synthetics for the shrinkage of jute market.

Though countries like Japan, Belgium, and West Germany have been making rapid strides in establishing jute industries of their own, danger to the Indian exports of jute manufactures comes from two sources, namely, aggressive competition from Pakistan, and disturbing domestic *milieu* for jute industry. Partition of the Indian subcontinent for the creation of Pakistan has seriously jeopardized the development of jute industry. Eastern States of West Bengal, Assam, Bihar, Orissa, and Tripura together with East Pakistan cons-

tituted the main jute growing region of the world. They account for over 75 per cent of the total world output. Before Partition, jute was grown mostly in the areas now included in East Pakistan whereas the manufacturing enterprises were located in India. This dislocation made it necessary for India to import a large bulk of raw jute from Pakistan, which itself has now begun establishing jute mills, thus threatening the well established jute industry in India. Most challenging threat to Indian jute industry thus comes from Pakistan.

Furthermore, Pakistan enjoys certain price advantage. Apart from the fact that the new establishments yield much favourable capital returns, even otherwise, she is able to underquote India. The Indian Jute Mills Association has estimated that Pakistan's price advantage has been of the order of Rs 950 per tonne for hessian and Rs 600 per tonne for sacking. The main reasons for this position have been the abundant supply of jute at a cheaper price and the existence of Export Voucher Scheme.²⁸ As a result of such price differentials and trading advantages, Pakistan has virtually captured India's overseas sacking markets; while Pakistan's share in the total exports of sacking from India and Pakistan taken together was only 28 per cent in 1960 but it increased to 58 per cent in 1966.

Pakistan's competition has not been confined only to sacking; its impact has been increasingly felt in other spheres as well. In the carpet backing trade, Pakistan has increased her shipment from just over 200 tonnes in 1963 to about 16,900 tonnes in 1965. The American burplap market is India's largest single export market for jute goods but Pakistan has entered there both in hessian and in carpet backing. In one year, India lost 5.1 per cent of the total market comprising 7.4 per cent in hessian and 1.2 per cent in carpet backing whilst Pakistan has gained 5.9 per cent of

²⁸ *Report of Indian Jute Manufacturers Association for the Year ending 1966*, I. J. M. A., Calcutta, p. XV.

that market consisting of 6.1 per cent in hessian and 5.7 per cent in carpet backing. In absolute term, the loss to India amounted to 18,000 tonnes valued at \$ 9.6 million or Rs 72 crores.²⁹

As a result of aggressive export policy adopted by Pakistan her share in jute exports has been increasing, specially at the cost of India. Pakistan's share in the world jute trade has increased from 6.8 per cent in 1957 to 33.5 per cent in 1966, whereas India's share in the total world off-take has during the same period decreased by 18.7 per cent. Pakistan's export of jute goods increased from 316,000 tons in 1965-66 to 350,000 tons in 1966-67, whereas Indian exports of jute goods as indicated above, declined from 918,000 tons in 1963-64 to 831,000 tons in 1965-66. Indian exports of hessian to the United States increased two and half times during the decade 1955-66 whereas that of Pakistan during the same period increased seven-fold.

Domestic economic situation of India has not helped the jute industry get out of woods. Exportable surplus of jute goods has not been increasing at a sufficiently faster rate. Jute manufactures depend upon the availability of raw jute which depends upon the vagaries of nature. Imports of raw jute even from Pakistan, besides due to several non-economic reasons, cannot be depended upon because both the countries lie in the same geographical region: shortages in one are likely to be accompanied by similar conditions in the other. Nonetheless, due to developmental programmes of jute cultivation in India, she has been able to increase her own production of jute goods from 945,000 tons in 1951-52 to 1,207,000 tons in 1965-66, but her internal consumption in the mill sector itself has increased from 147,000 tons in 1951-52 to 190,000 tons in 1955-56, 274,000 tons in 1960-61, 314,000 tons in 1962-63, 380,000 tons in 1964-65 and 409,000 tons in 1965-66.

Exports of jute manufactures from India have therefore

²⁹*Ibid.*, p. XVI.

amounted to only 795,000 tons in 1951-52, 860,000 tons in 1955-56, 764,000 tons in 1960-61, 918,000 tons in 1963-64, 907,000 tons in 1964-65, and 831,000 tons in 1965-66. Apart from the increasing level of domestic consumption, the levy of export duties has been another serious impediment to the expansion of jute goods trade. Over and above this, the disputes over bonus, gheraoes, and many unlawful activities among the jute workers have also been harmful. During the decade 1957-67, there has been a sharp increase in the number of strikes, lock-outs and consequential loss in man-hour. Some of these disturbances did not have anything to do with industrial disputes. For example, it has been estimated that 91 per cent of the stoppings involving 538,857 workers and a loss of 4,497,694 man-hours had nothing to do with industrial disputes; they were caused by such political factors as hartals, bandhs, etc.

Obviously, the challenge to the Indian jute industry has not been feeble. It can recover only under deep-acting stimulus. The international trading situation specially after the cut under the Kennedy Round of 23 per cent—15 per cent import duties on sacking 23-20 per cent on heavier hessian, and 23 per cent to 20 per cent on carpet backing—on import duties on jute manufactures followed by similar reductions in the United States, Japan, Norway, Sweden, and Demark should enable the Indian jute exports to pick up, but this gain would be available even to the competitors of India. This would reduce the prospect of Indian jute exports.

Tea

Tea is an important foreign exchange earner for India: it accounted for 13.3 per cent of her total exports in 1950-51, 18.3 per cent in 1955-56, and 14.3 per cent in 1966-67. Production of tea has been increasing significantly. India produced 613.35 million lbs of tea in 1950 which increased to 678.37 million lbs in 1955, and 707.85 million lbs in 1964. Area under tea plantation has increased from 783,000 acres in 1950 to 792,000 acres

in 1955, 818,000 acres in 1960 and 844,000 acres in 1964. Despite this, the share of Indian tea in world exports has been declining: in 1948. Indian tea accounted for 50.5 per cent of world exports which declined to 37.9 per cent in 1955 and in 1964 it accounted for only 33.2 per cent.

Demand for tea does not grow very fast; it has been estimated to grow at a rate of less than 3 per cent per year. The rate of growth in tea consumption during the post-war years, however, has been substantial in tea producing countries: the per capita consumption of tea during the First Plan period in India itself increased from 0.45 lbs in 1950 to 0.58 lbs in 1955. But no significant increase in per capita off-take has been noticeable in traditionally important tea importing countries like the United Kingdom, the Netherlands, Ireland, the United States, and Canada. In the United Kingdom, however, with the highest per capita consumption of tea, the increase in consumption has been only around 2 per cent per annum. World demand for tea consumption has thus been less elastic.

On the other hand, the supply position of tea has been very easy. This has been so due to extension of the area of tea plantation in different regions of the world as well as due to increased production from the existing plantations themselves. The leading tea producing countries till the Second World War had been the South and the South-East Asian countries such as China, India, Ceylon, Indonesia, Formosa, which taken together produced about 98 per cent of total tea production till 1952. Since then, there has been extension of tea plantation in African countries and now Malawi, Kenya, Uganda, Tanganyika, and several other countries have entered the tea market. As a result of such extension programmes, the share of these countries in the world exports has been increasing: the share of Ceylon increased from 30.2 per cent in 1951 to 35.4 per cent in 1961 and 36.2 per cent in 1966; East Africa which includes Kenya, Uganda, Tanzania, Malawi and Southern Rhodesia increased its share from 3.0 per cent in 1951 to 5.9 per cent in 1961 and 9.8 per cent in 1966. Other African countries which accounted for only

2 per cent of world tea production prior to 1950-52 has increased their share to 8 per cent during 1959-61.

India has not, however, been able to maintain similar rates of growth in its exports. There have been several reasons for the same. Firstly, the quality of Indian tea has been deteriorating. Tea production is partly controlled by varying the period of plucking: the quality of leaves plucked determined to a great extent, the quality of tea produced. Resorting to coarser plucking is only one of the factors for its deterioration. Neglect of tea gardens, absence of scientific plantation, lack of adequate inputs like fertilizers, and the non-availability of experienced labour for plucking have adverse effect on tea production. Moreover, many of the Indian tea gardens are old: more than 52.1 per cent of the bushes have been estimated to be between 26 to 60 years of age, and 21.4 per cent have been more than 60 years of age. But, tea plants need replenishments; on an average, after an interval of 40 years this operation should be carried out. In order to obtain good flavour tea, replantation of good quality tea with proper and adequate manuring is essential. This, however, has not been adhered to in India.

Secondly, the Indian prices have been non-competitive. Till 1960, Ceylon tea was the costliest and the Indian tea price was next to Ceylon tea. For example, in 1951, the north India tea was selling at 3s. 7.9d per lb in London market whereas the Ceylon tea was priced 3s. 10.05d per lb. The African tea was costing at that time only 3s. 3.04d per lb and the Pakistan tea 3s. 5.09d. In 1955, prices of all tea had risen. At that time, the Ceylon tea was costing 5s. 4.33d per lb, north India tea 5s. 3.59d per lb, Pakistan tea 4s. 7.49d whereas the Indonesian tea cost 3s. 10.3d and the African tea 3s. 8.82d per lb. In 1960, prices of north India tea and Ceylon tea were almost at par: north India tea was sold at 4s. 11.19d per lb and Ceylon tea at 4s. 11.89d whereas Indonesian tea was sold at 3s. 5.49d per lb and Africa tea at 3s. 6.53d. In 1965, north India tea was the costliest, selling at 4s. 4.30d per lb and Ceylon tea, its nearest rival was sold at 4s. 3.15d, i.e. 1.15d per lb less than the Indian

tea. Africa tea was sold at 3s. 8.34d per lb and Pakistan tea at 3s. 3.34d. Evidently, the price differential has been significantly adverse for the Indian tea.

Thirdly, the consumer preference has also turned against India. This changeover is not so much due to change in taste as much due to other considerations. The erstwhile tea plantations in India were mostly owned and managed by British planters. It was a kind of "foreign enclave." During the post-war period, specially during and after the Independence movement, the foreign investment has been transferred to East African countries having similar climatic and geological conditions and the management of Indian plantation has shifted to Indian businessmen. This trend has affected the closer liaison between the British and the Indian interests. In many tea producing areas of India, cooperative societies for tea processing have now been organized. As the quality of tea production depends very much on personal supervision, the cooperativization, in many cases, has not been very helpful in this regard. The British tea market, which has been the most important tea market in the world, has, therefore, become lukewarm to Indian tea. This is reflected in significant increases in importation of Ceylon and African tea. Over the ten-year period 1948-58, the British tea imports from India increased by 20 per cent, while those from East Africa increased by as much as 300 per cent; Ceylon has, however, maintained a more or less stable position. During 1959-65, Indian exports to the United Kingdom have actually declined in quantity: in 1959, 284,386 thousand lbs were imported from India which amounted to only 252,486 thousand lbs in 1965, whereas Ceylon tea increased from 137,361 thousand lbs to 175,942 thousand lbs; Kenya tea increased from 8,959 thousand lbs in 1955 to 13,994 thousand lbs in 1960 and 25,990 thousand lbs in 1965; Uganda increased its exports from 3,580 thousand lbs in 1960 to 4,793 thousand lbs in 1965 and Tanganyika from 2,072 thousand lbs in 1955 to 6,112 thousand lbs in 1960 and 7,806 thousand lbs in 1965. This shows that the demand has

been gradually shifting away from the Indian tea.

Fourthly, tea industry in India has been facing many internal difficulties. The burden of welfare legislations and fiscal measures has been heavy. This is so, specially when compared with other tea producing countries. The Plantation Labour Act, 1951, requires that the industry must provide several facilities for the workers. Construction and maintenance of hospitals and houses for the workers put additional burden. Moreover, the middlemen in this trade appropriate a significant portion of the unit value paid by the consumers; the industry is thus precluded from sharing adequately the gains of the trade, and the consumers have to pay higher price for recovering the cost of the entrepreneur. It has also been argued that the Indian withdrawal from the International Tea Market Expansion Board in 1952 has been unhelpful because the competitors who are still members of the Board have been able to secure for themselves larger share in the world trade as a result of the aggressive marketing policy of the Board. How far the Indian Tea Board would be able to counteract these shortcomings is still to be seen.

Lastly, the latest devaluation of pound sterling (in September 1967) accompanied by devaluation of the Ceylonese currency by 20 per cent has further intensified the Indian difficulty. Because every pound now fetched three rupees less, it has been estimated that the Indian tea exporters would lose in a year about Rs 25-30 crores. Moreover, the Ceylonese simultaneous devaluation would further assist the Ceylon tea to pick up. This may be to the detriment of the Indian tea. Evidently, therefore, the Indian tea industry has an uphill task in order to expand its export trade.

Cotton Manufactures

The cotton manufacturing has been a well established traditional industry in India accounting for a substantial share in her export trade. But, during recent years, as Dr Benjamin I. Cohen has rightly indicated, India has failed to maintain her

relative position even with regard to this item (including cotton textiles, ready, made garments as well as cotton yarns and thread). This item has fluctuated around 8 per cent of the total Indian exports though in 1955-56, it accounted for 10.5 per cent of the total exports and 9.4 per cent in 1960-61. In volume, 628 million sq. metres of cotton fabrics were exported in 1960-61 which declined to 553 million square meters in 1965-66 and 438 million square meters in 1966-67. Some of the conflicting government policies which have seriously hampered the growth of this sector have already been indicated earlier. But, the malady is still deeper. A closer examination of the situation would reveal that changes in the distribution of cotton textile industries in different countries have seriously affected the relative Indian position. Unless drastic steps are taken, the condition may be beyond redemption and probably, in view of non-economic involvements of the problem, it would relegate cotton textile industry in near future to the background catering only for the sheltered domestic consumption market.

Once upon a time, the United Kingdom and the United States had been tremendously important producers of cotton textiles. As late as in 1914, the cotton spinning and weaving mills in the United Kingdom gave employment to 624,000 persons and contributed about one-fourth of the value of her total exports: the United Kingdom exported about four-fifths of its cotton piece-goods and led world trade in textiles with nearly 60 per cent by value of the world's export of cotton piecegoods. No other country was a serious competitor to it. But the position of the country since then has changed. Presently, the British cotton mills employ only 180,000 persons and the mill consumption of raw cotton in the country in 1963 was less than 40 per cent of the 1939 level. This shows how rapidly the relative position of a country in this regard can decline.

It is significant to note that the textile manufacturing units in the world are widely diffused: practically every country participates in the fabrication of one or more kinds of clothing. Even cotton is grown in more than 70 countries, mostly

for domestic consumption, and only about one-third of it is exported. During the period following the First World War, the world output of cotton has expanded two and a half times. In spite of this diffusion, four countries, namely, the United States, Mainland China, the USSR, and India accounted for nearly 70 per cent of the world cotton production. But the Soviet Union does not hold the textile industry in high priority and therefore despite the fact that her consumption of raw cotton has increased 2-1/5 times over the 1939 level, she grows more cotton than she consumes.

It is presently the Asian countries where cotton manufacturing is concentrated in any significant degree. Mainland China, India, Japan, and Pakistan are the large manufacturers of cotton, together they fabricate more cotton than the combined mill consumption of America, Africa, and Australia. But this very concentration has led to the process of decline of Indian exports in cotton manufactures. Pakistan and Mainland China due to their geographical advantages, and Hong Kong and Japan due to their technological superiority have given formidable competition to Indian exports in this item. Besides, three other factors have also created difficulties for India. These factors have been the recent trend in industrialization in several underdeveloped countries, the emergence of synthetic and man-made fibres, and the prohibitive import barriers erected by the more developed countries against textiles from developing regions.

Pakistan provides an outstanding example of post-war development in cotton manufacturing. The first cotton textile mill in Pakistan was set up after Partition. The volume of raw cotton processed in Pakistan has increased from 22,000 tons in 1950 to 230,000 tons in 1960. During the first quinquennium, the main objective had been to meet the domestic requirements, but from 1955, Pakistan has entered the export trade and has begun threatening the Indian position. Since 1959, she has become one of the world's leading exporters of cotton yarn. Moreover, Pakistan has built up significant capital stock and has acquired skill to such an extent that the cotton proces-

sing in Pakistan has added about 130 per cent to the value of raw cotton, domestic factors of production alone being responsible for about 85 per cent. Thus for every dollar's worth of cotton exported in the form of textiles rather than as fibres, Pakistan earns an additional 85 per cent of foreign currency.³⁰ With increased domestic availability of raw cotton, establishment of new mills with upto-date machinery and with disciplined workers accompanied by Export Bonus Scheme, Pakistan has been successful in expanding her exports at the cost of India.

Similarly, Hong Kong has entered in a big way the export market in cotton manufactures. The growth of Hong Kong cotton textile industry has however been based on imported raw cotton. Most of the cotton mills in Hong Kong have been set up between 1948 and 1956 chiefly due to the diversion of investment resources by the Chinese (Mainland) entrepreneurs due to political reasons. As a result of this trend, several new units were set up raising the mill consumption of raw cotton from 21,000 to 70,000 tons, and exports of cotton manufactures from about 50,000 to over 105,000 tons between 1950 and 1960.³¹ These new spinning mills have been "as upto-date and as efficient as can be found anywhere in the world and housed in modern factory buildings," specially in contradistinction with the Indian mills with outmoded ancient machinery. The Hong Kong industry has latest types of automatic looms and modern units for pressure dyeing of yarns in packages.

Garment making and knitting mills which existed as parts of cotton industry before the wars have now been modernized. Presently, Hong Kong's high speed sewing machines have been producing shirts, pyjamas, women's blouses, brassiers, and other articles. The knitting units have also been producing shirts and underwears, socks, towels and even gloves. The

³⁰"Trade in Agricultural Commodities in the U.N. Development Decade," *FAO Commodity Review*, 1964, Special Supplement, Vol. I, Parts I, II, and III, F.A.O., Rome, pp. 111-23.

³¹E. Szyzpepanik, *The Economic Growth of Hong Kong*, Oxford University Press, London, p. 107. •

cost of production in Hong Kong compares favourably with that in developed countries and as such, Hong Kong has extended its market even in America and Europe besides capturing most of the Asian ones. In 1959-61, the largest flow of textiles from developing to developed countries originated in Hong Kong. Its tissues have found especially good markets in the United Kingdom where they profited from Commonwealth Preferences, rising demand and the partial obsolescence and high overhead of Lancashire textile industry. Hong Kong garment makers concentrated on exports to the United States the price and quality of the garments were such that the American importers ordered them in large quantities. How far India has been affected by the establishment of cotton mills in developing countries can be assessed from Table 4 showing trade of developing countries in cotton manufactures during 1953-55 and 1959-61.

The table shows that the exports of developing countries have been increasing rapidly. In 1953-55 only 165,300 tonnes of cotton goods accounting for \$ 245.5 million were exported from the developing countries which in 1959-61 amounted to 266,800 tonnes accounting for \$370.2 million. It is significant to note that the exports from one developing country to another such country during the same period increased from 132.4 tonnes accounting for \$ 194.0 million to 141,000 tonnes accounting for only \$ 193.1 million whereas the expansion of exports to developed countries had been substantial rising from 30,300 tonnes valued at \$ 48.2 million in 1953-55 to 119,200 tonnes valued at \$ 166.8 million in 1959-61. This rate of increase has been shared with them by Pakistan, UAR, Hong Kong as well as by other developing countries but India has failed to keep pace. In fact, India's exports to the world as a whole, as well as to other developing countries have declined markedly.

This change in the relative position of Indian cotton textile

TABLE 4
TRADE OF DEVELOPING COUNTRIES IN COTTON MANUFACTURES

	World		Developed Countries		Developing countries		Centrally planned countries	
	1953-55	1959-61	1953-55	1959-61	1953-55	1959-61	1953-55	1959-61
Exports from Developing Countries to								
Volume :	165.3	266.8	30.3	119.2	132.4	141.0	2.6	6.6
Value :	245.5	370.2	48.2	166.8	194.0	193.1	3.3	10.3
Hong Kong								
Volume :	46.5	93.2	6.7	60.5	39.8	32.7	—	—
Value :	77.1	135.0	12.9	86.2	64.1	48.1	0.1	—
India								
Volume :	103.5	91.1	18.6	33.6	84.9	57.1	—	0.4
Value :	145.2	138.8	27.0	49.8	118.2	88.6	—	0.4
Pakistan								
Volume :	0.6	33.2	—	5.4	0.6	27.8	—	—
Value :	0.5	28.7	—	6.5	0.5	22.2	—	—
U.A.R.								
Volume :	9.9	24.1	2.6	9.7	4.7	8.4	2.6	6.0
Value :	13.3	35.8	3.5	11.5	6.6	14.7	3.2	9.6
China (Taiwan)								
Volume :	—	12.0	—	3.6	—	8.4	—	—
Value :	—	14.3	—	4.6	—	9.7	—	—
Other Developing Countries								
Volume :	4.8	13.2	2.4	6.4	2.4	6.6	—	0.2
Value :	9.8	11.6	4.8	8.2	4.6	9.2	—	0.2
Imports into Developing Countries from								
Volume :	466.4	501.0	312.0	290.0	132.4	141.0	22.0	70.0
Value :	1018.3	961.1	792.0	675.0	194.0	193.3	32.3	93.0

SOURCE : Trade in Agricultural Commodities in the U.N. Development Decade, F.A.O., Part III, p. 50.

industry has been due to the setting up of a large number of spindles and looms in developing countries and thereby augmenting their production possibility. The number of Indian spindles increased only from 10,534,000 in 1951 to 13,985,000 in 1961 and that of looms over the same period increased from 198,473 to 206,525 but the expansion in other 19 countries such as Burma, China (Taiwan), Hong Kong, Indonesia, Iran, Iraq, Israel, Lebanon, Pakistan, Philippines, South Korea, South Vietnam, Syria, Thailand, Congo, Ethiopia, Nigeria, Cuba, and El Salvador has been spectacular: the number of their spindles increased from 1,214,000 to 6,052,000 and looms from 28,411 to 143,567.

As a result of such expansion programme in the cotton processing capacity of the developing countries during the post-war period, the total volume of cotton manufactures shipped from developing to developed and centrally planned regions increased by some 5 per cent per year gathering momentum in the late fifties. In 1953-55, the only exporters of note were India and Hong Kong, but by 1959-61, Pakistan and UAR emerged as major exporters, while China (Taiwan), Mexico, Israel, and South Korea laid foundations of viable export industries. The most striking feature of this development, which vitally cut into the Indian export market, has been the shift from intra-trade to markets in developed countries. Between 1953-55 and 1959-61 exports to developing countries rose by barely 6 per cent while exports to developed and centrally planned regions quadrupled. India's position has to be compromised because of the self-sufficiency policy adopted by many developing countries and competition from the Chinese and Pakistani products. Indian textiles, like those from Hong Kong, found expanding outlet in the British market but this was insufficient to offset the loss experienced in developing countries. During this period, Pakistan became a major supplier of cotton yarn to weaving and knitting mills in several countries of Asia and the Far East and it also captured a large share

of the United Kingdom market for tissues. The UAR has substantially increased its shipment of yarns to the Federal Republic of Germany and the Scandinavian countries as well to the German Democratic Republic and Czechoslovakia, while finding an expanding market for its tissues in the United States. In fact, India has been hoping to expand her exports to these countries which under the changed conditions has become difficult. Exports from China (Taiwan) which did not begin until the late fifties have been directed chiefly to other developing countries in Asia and the Middle East, but there have been emerging promising markets for its tissues and made-up articles even in the United Kingdom, Mexico, and Israel. South Korea supplied mainly to her neighbouring regions. These developing countries have been making in-roads even in the markets of the United States, the United Kingdom, and other European countries.

As a result of this trend of industrialization in the developing countries, it is noticeable that the Indian exports to many of her traditional markets have been declining. For example, exports of cotton piece-goods to Kenya declined from Rs 2.4 crores in 1960-61 to Rs 1.9 crores in 1966-67, to Sudan from Rs 4.25 crores in 1960-61 to Rs 3.3 crores in 1966-67; during the same period Indian exports to Afghanistan declined from Rs 2.16 crores to Rs 1.1 crores, to Burma from Rs 1.47 crores to negligible amount, to Ceylon from Rs 3.04 crores to Rs 2.3 crores, to Australia from Rs 4.45 crores to Rs 2.28 crores, to Aden from Rs 2.25 crores to Rs 1.68 crores, and to the Netherlands from Rs 0.6 crores to Rs 0.09 crores.

This declining trend has been further accentuated by the development of synthetic fibres and the imposition of tariff barriers and quotas in several developed countries. Presently, one-third of world production of rayon and acetate filament, two-fifths of the rayon and acetate staple, and a third of non-cellulosic fibres are concentrated in Europe, where the United Kingdom, Italy, West Germany, France,

and the Netherlands are the large producers. This innovation has not only seriously affected the cotton piece-goods trade but has also influenced the woollen trade. The technological requirements of these industries and their spread in Japan, India, Mainland China, and Turkey, besides in the United States, and the USSR have already started a new trend against any further expansion and growth of traditional Indian cotton textile industry. Evidently, India has a losing battle to fight for encouraging her exports of cotton manufactures unless she decides to make revolutionary amends to her textile development policy.

Leather Exports

Indian leather exports consist of (i) raw hides and skins, (ii) footwear, and (iii) other leather manufactures which include such items as brief-cases, ladies' hand-bags, gloves, and other travel goods. Table 5 shows the exports of Indian leather industry.

From this table, it may be seen that the exports of leather and leather goods during the First Five Year Plan declined from Rs 36.4 crores in 1950-51 to Rs 30.1 crores in 1955-56. Since then, the exports have gradually picked up rising to Rs 37.6 crores in 1960-61 and Rs 43.9 crores in 1965-66 and showing a phenomenal growth to Rs 81.9 crores in 1966-67. It is significant to note that the "other leather manufactures" have been fluctuating around two-thirds of the total leather exports (excepting during the First Plan period and in 1966-67); the exports of footwear have risen from 2.2 per cent of the total to 10.3 per cent whereas the proportion of hides and skins has been declining from 26.4 per cent of the total in 1950-51 to 18.8 per cent in 1966-67. The structural shift from exports of raw hides and skins to finished products is the natural consequence of the developmental process, but the relative importance of leather goods in the total exports of India did not show any decline, rather there

TABLE 5
EXPORTS OF LEATHER AND LEATHER GOODS

(Value: Rs Crores)

Year	Hides and Skins (Raw)	Footwear	Other Leather Manufactures
1950-51	9.6	0.8	26.0
1951-52	8.5	1.7	25.9
1952-53	5.7	2.1	20.6
1953-54	6.1	1.9	25.5
1954-55	7.2	1.6	21.0
1955-56	6.6	1.5	23.0
1956-57	6.0	1.3	21.3
1957-58	6.8	2.8	21.1
1958-59	8.1	2.1	18.9
1959-60	11.2	2.9	30.7
1960-61	9.5	3.1	24.8
1961-62	8.2	2.4	25.3
1962-63	10.1	2.8	22.6
1963-64	9.6	3.6	26.4
1964-65	9.7	4.2	27.4
1965-66	9.9	5.3	28.8
1966-67	15.8	8.4	58.4

SOURCE : *Monthly Statistics of Foreign Trade*, Department of Commercial Intelligence and Statistics, Government of India, Calcutta.

has been some improvement: between 1950-51 and 1965-66, this sector accounted for a little over 5 per cent of the total which in 1966-67 accounted for 7.5 per cent. This upward turn is a heartening sign and it would be worthwhile examining whether this direction could be maintained as a long-term trend.

Presently, leather goods industry of which footwear production constitutes the major share is primarily a concern of developed countries. This is so, primarily due to two conditions. Firstly, the production of hides and skins, excepting furskins and rabbit skins, is based on byproducts of the livestock industry. Since meat, dairy products, and wool are produced mainly in developed regions, these areas contribute approximately 45 per cent of the world output of hides and skins, besides 25 per cent produced in the centrally planned

economies. Secondly, footwear which is the primary end-product of leather goods industry has very high income-elasticity of demand estimated at 1.0 to 1.5, and other consumer goods made of leather, for example, brief-cases, women's hand-bags, gloves, and certain types of clothing and furnishings have the income-elasticity of 1.5 to 2.0 times the growth of real income per head. This suggests that the developed countries where the rise in national income has been substantial would provide the best market possibility for such goods.

However, this industry has been spreading in other countries too. Though the main areas producing hides and skins have been the United States and the European Economic Community, sheep and goat skins are produced mainly in the Mediterranean region. Australia, New Zealand, and South Africa. Among the developing countries, India is the world's largest goat producing country: its annual availability has been 25.4 million pieces of hides and 43.6 million pieces of skins. India ranks the third largest producer in the world of hides and skins. Among the other developing countries, Argentina and Brazil are major producers of cattle hides and Argentina and Uruguay, of sheep skin. Sheep and goat skins are produced in the Middle East, and cattle hides and karakul pelts in Africa. China (Mainland) is the world's main source of pig skins, while the USSR is an important producer of cattle hides, calf and sheep skins. Even Pakistan has been expanding her production of hides and skins.

The existing capacities of recognized tanneries in Pakistan have been estimated at 74,293 million sq. ft. for chrome tanned hides and skins and 2.5 million sq. ft. for vegetable tanned hides and skins including sole and kip leather and 200 kgs of other types of leather. In Karachi alone, 25,000 pieces of hides and skins are being tanned daily. Evidently, the developing countries are vigorously entering the leather goods industry, and it will require greater efforts for India to maintain, if not improve, her position.

The world trade in leather goods follows the demand and

supply forces: the developed countries while generating substantial demand for them also produce the bulk of the supplies of hides and skins and they account for the largest proportion of world trade in these items. In 1953-59, 59 per cent of world trade in hides and skins was between developed countries which by 1959-61 increased to 66 per cent. Simultaneously, imports of hides and skins into developed regions rose by almost 40 per cent chiefly as a result of expanding trade between the countries of the European Economic Community. But as the developing countries have also been expanding their production of leather goods, their exports to developed countries rose by 6 per cent between 1953-55 and 1959-61 which has also been the rate of increase in world trade in hides and skins during the period. From this expansion of exports, the Middle East, South Asia, and the Far East have gained though slightly. The greatest relative increase in imports of hides and skins occurred in the USSR and the Eastern Europe where imports trebled during the period between 1953-55 and 1959-61 changing their position from a position of net exporter to that of a substantial net importer.

Impact of these changes on the Indian exporters, as indicated earlier, has been very favourable. While commenting upon the export performance of Indian leather and allied products during the last fifteen years, D. Simon and K. Seshagiri Rao have expressed optimism when they stated that 'the structural changes in our exports (increasingly in favour of wet blue chrome and semi-tanned hides and skins, and finished leather and leather products) that are taking place have boosted the export sector and if the present tempo of trade with East European Countries continues we envisage that the actual export earnings in 1970-71 would substantially exceed the export target level of Rs 100 crores.'¹²

Undoubtedly, the leather industry has been reorganizing

¹²D. Simon and K. Seshagiri Rao "Export Performance of Indian Leather and Allied Products during the Three Plans," *Leather*, Leather Export Promotion Council, Madras, May 1968 p. 19

itself to meet the challenge. It is no longer a feeder to the British leather manufacturers. Her market has diversified. India's exports of leather footwear have been directed to about 75 countries of the world of which the leading importers have been the USSR, the United States, the United Kingdom, Kuwait, Aden, Australia, Behrein and Sudan. The USSR claimed a share of 31 per cent of Indian exports in 1965-66 as against 15.6 per cent in 1964-65 and 20.8 per cent in 1963-64. The United States also improved its share from 13.7 per cent in 1963-64 to 20.4 per cent in 1965-66. Leather footwear exported to the USSR are generally good quality gents shoes, ladies chappals, bellarinas, etc., whereas those to the general currency area consisted of children shoes and low priced chappals and sandals.

But, in this context, it may also be noted that other developing countries notably Pakistan, has also been augmenting her exportable surplus. Leather ranks third amongst Pakistani exports of manufactured goods. She exported leather goods worth Rs 3.76 crores in 1963-64 which increased to Rs 5.83 crores in 1964-65, Rs 9.97 crores in 1965-66 and Rs 12.82 crores in 1966-67. This gives an annual rate of growth of 80.3 per cent as against only 35.6 per cent for India. Pakistan also has been selling leather goods to a large number of countries such as the United Kingdom, West Germany, the United States, Italy, France, Japan, Sweden, and Belgium. She has even made in-roads to Afghanistan, Yugoslavia and other socialist countries. She has also been hoping that with improvement in her friendly relations with the USSR and other centrally directed countries her exports of leather goods would get a further boost up. Apparently, there is no justification for complacency in India, and in fact, "the political and economic transformation taking place in the Indian scene since independence, would require reorganization of the industry and trade... to keep pace with the changing phase."³³

³³P.A. Nair and O.S. Krishnamurthy, "Leather Tanning Industry in India: the Structure of its Export Sector," *Asian Economic Review*, Hyderabad, Vol. VII, 1964-65, p. 246.

There are several difficulties in reorganizing the Indian leather industry. Against a production of 140 million pairs of footwear in 1966-67, the target for 1970-71 has been fixed at 200 million pairs of which 12.5 million pairs are expected to be exported. Similarly, exports of footwear components such as cowboy uppers, conventional uppers, cut soles and heels are also being developed. Attempts to increase exports of other leather goods are also being made. Points for consideration in this context have been (i) whether the rate of expansion envisaged in this category is commensurate with the rate of increase in the world trade, (ii) what should be the possible lines of approach to promote the expansion, and (iii) whether the direction of trade needs reorientation.

Rates of expansion in the world trade in leather goods would depend upon (a) the rate of growth of national income in different countries, particularly so in this regard because of the high income-elasticity of demand for these items, (b) the prospect of supply position with regard to hides and skins and the manufactures thereof, and (c) the rate of substitution between leather and synthetic materials. Secondary factors include the growth rate of leather consumption in other uses such as clothing and accessories, and demand for furs, both of which vary not only with changes in income but also with changes in the levels of living. Applying the relevant income elasticities for each of the developed countries to the expected rates of population and income growth, the total footwear consumption appears likely to rise by 30-40 per cent between 1959-61 to 1970. Demand for other consumer goods made of leather may rise even faster. The introduction of P. V. C. and other leather substitutes will have to be taken into account in assessing the requirement for hides and skins. During the present decade, substitution against leather is likely to continue in those uses where synthetic materials have technical advantages as in the case of in-sooling, travel goods and upholstery materials, but in such cases where this is not the case, the rate of substitution will be determined

primarily by the relative prices of leather and synthetics.

Considering all these points, it has been estimated that the total consumption of cattle hides and calf skins in developed countries in 1970 would be 1.66-2.07 million tonnes or up to about 30 per cent higher than the 1959-61 average of 1.62 million tonnes.³⁴ This shows that the target set out for India envisages at least maintenance of its present share in the world expansion but the likely growth of hides and skins in developed countries is expected to be substantial, so the optimistic target as laid down for India will have to be accompanied by other steps in order to achieve the same. This implies that India will have to consider seriously the question of collection, processing, mechanization, standardization, pricing and sales organization earnestly. Hides collected for processing and offered for exports often fail to reach the high standard of quality for several reasons. Damages can result while the animal is alive through branding, scratches, parasites and diseases, during slaughtering, flaying and curing and also while storing and transporting. Moreover, inadequate feeding and animal care practices have to be removed in order to better the quality. The controversy between large-scale and decentralized sectors of production should also be examined from economic standpoint, and not purely on the basis of privileges and protections of ill-equipped classes of the society.

At present, the Indian exports of leather goods are heavily concentrated in Rupee Payment Countries. This is done so under bilateral trade agreements. This trend should be viewed carefully. Recent rates of wide fluctuations in the quantities imported by these countries as well as in the prices offered by them suggest that there cannot be long-term stability in trade with these countries. Moreover, these items are highly income-elastic and the prospect of this taking place in the centrally directed economies more favourably than in the free democratic countries is dim. So the need for searching an alternative

³⁴*Commodity Review, F.A.O.*, pp. 11-121.

market is great. The per capita consumption of leather goods in the United States also seems to be nearing saturation point. It is therefore advisable to establish better marketing arrangements in Western Europe and Japan. The developing countries with immense possibility for raising the level of their consumption as well as for increasing their growth rates should provide better alternatives.

At a recent seminar held in January 1969 organized by the Export Promotion Council for Leather in Madras, it was suggested that the Indian leather industry has been facing rough weather and it has to operate under great handicaps which disable it from obtaining the desired level of exports. To name a few of the handicaps there have been world recession in leather industry and keen competition from newly developing countries like Pakistan, China (Mainland), Nigeria, Iran, and Turkey. Pakistan has been granting incentives to its exporters to sell at prices 20 to 30 per cent cheaper than the Indian quotation, China sells tanned hides and skins at any cost. In countries where India enjoyed monopolistic position, it is now facing hard competition. This highlights the difficulties in achieving the target as laid down and improving the relative position of Indian leather goods exports. The task in this sector is however not formidable.

Cashew Kernel

Exports of cashew kernel have increased five-fold between 1950-51 and 1966-67. During the last three years or so, the exports of cashew kernel have doubled, rising from Rs 21.4 crores in 1963-64 to Rs 42.8 crores in 1966-67. During the First Plan period, the annual exports fluctuated between 21.6 and 34.6 thousand tonnes and averaged 28.7 thousand tonnes. During the Second Plan period, the annual average exports went up to 38.3 thousand tonnes or by about 33 per cent. They rose steadily to 55.5 thousand tonnes in 1964-65 from 43.6 thousand tonnes in 1960-61 except for a slight setback in 1959-60. During the last few years, the upward trend has been

arrested and the volume of exports declined to 50.5 thousand tonnes in 1965-66 and 49.5 thousand tonnes in 1966-67. Therefore, the apparent gain in value terms has been due to rising international prices which may not continue for long.

Demand for cashew kernel is also highly income-elastic but most markets for this commodity have not yet been fully exploited. About half of the product goes to the United States and one-third to the USSR. During the last few years, the consumption of the USSR has been increasing—from Rs 3.4 crores in 1963-64 it has increased to Rs 12.8 crores in 1966-67—but the rate of expansion in the United States has not been very satisfactory. Exports of cashew kernel to the United Kingdom amounted to Rs 2.4 crores in 1966-67 as against a little over Rs 1.0 crores during the preceding six years. Australia imported cashew kernel worth of Rs 1.5 crores in 1966-67 and in that year the imports by East Germany amounted to Rs 1.8 crores. From this, it may be observed that the per capita consumption of cashew kernel is yet very low in most of the importing countries excepting in the few countries mentioned above. Furthermore, considering the relative prosperity of countries in Latin America, East Africa, and Western Europe, cashew kernel has bright prospect for its expansion in these countries as well.

The real problem in this regard, however, hinges around the possibility of expanding the supply of the nuts. So far, the domestic production of cashewnuts amounted to only half the kernels processed in the country. More than 155 thousand tonnes of cashewnuts are imported every year from African countries. Mozambique and Tanganyika taken together met 94 per cent to 99.5 cent of the Indian requirements. So far India has been importing almost the entire exportable supplies of Africa. At present, three-fourths of the kernels produced in India are exported. But, new processing units are being set up in cashewnut producing countries of Africa, specially in Mozambique, Kenya, and Tanganyika. Mechanical processing of cashewnuts is being attempted in Portugal, Italy, the United

Kingdom, and Brazil. As a result of these developments, the overseas demand for Indian cashew kernels has already taken a downward trend and India no longer enjoys the monopoly in the export trade of cashew kernels which it once did. Whether this trend can be arrested or not would depend upon research results with regard to extension of cashew plantation in other new regions of India and on the outcome of the aggressive export policy in promoting consumption of cashew kernel to other advanced as well as developing countries.

Iron Ores

Among the three mineral deposits, namely, mica, manganese, and iron ores in which India enjoys certain special advantages, iron ores have been showing noticeable possibility for their future expansion. Dr Cohen, as indicated earlier, has already mentioned the difficulties confronting expansion of manganese ores. It is doubtful whether the earlier superiority with regard to manganese ores can ever be attained. Mica has limited use. It is for such reasons that the exports of mica and manganese which accounted for Rs 28.9 crores in 1951-52 amounted to Rs 24.8 crores in 1956-57 and only Rs 26.7 crores even in 1966-67. As against this, exports of iron ores increased from Rs 0.2 crores in 1950-51 to Rs 9.3 crores in 1956-57, Rs 35.4 crores in 1961-62, and Rs 65.3 crores in 1966-67. Evidently, certain special factors have helped the exports of iron ores.

Iron ores have tremendous influence on our contemporary civilization. Transportation and communication equipment, machines of all types, large buildings, tunnels and bridges are all basically dependent upon iron and steel supply in various forms. Iron is a kind of metal which can be transformed into various forms and degrees of hardness. It can be cast, hammered, rolled, drawn into wire, welded and combined with many other metals; and it can be hardened, softened and re-hardened subjecting this metal to different processes and adding small amounts of alloy metals, steel can be imparted almost any degree of desired hardness. As a result of such possibilities, the need for this metal has increased tremendously.

At present, there are five main groups of countries where imports of iron ores are concentrated. These countries are the United States, the United Kingdom, Western Europe, East European Socialist countries, and Japan. In fact, these are the industrial centres of the present world. But, all of them have their specialized and well-established centres of supply. The United States obtains iron ores mainly from her own mineral deposits which account for 16 per cent of the world iron ores mined; the only other country which exceeds her in this respect has been the USSR whose output of iron ores amounted to 21 per cent of the world total. The United States imports iron ores from several African countries, besides importing them from Latin America and South America. Cheap transport facilities have been an important consideration in such transactions. Special rates for ocean transportation have enabled the United States to import her iron ore requirements from distantly located countries. This also explains the export of iron ores from the Philippines to the United States.

The United Kingdom has substantial iron ore deposits of her own, nonetheless, similar facilities of special cheap rates of ocean transportation induce her to import about 18 million tonnes of iron ores every year from Sweden, besides importing some quantities of iron ores from such African countries as Algeria, Morocco, Liberia, and Sierra Leone. Canada also supplies a substantial portion of iron ores required by the United Kingdom. West European countries such as West Germany (365), Belgium-Luxembourg (208), France (15), and Italy (26) taken together annually imported over 600 lakh tonnes of iron ores. These countries themselves have substantial deposits of iron ores, still they import them because of geographical considerations. They import the ores mainly from adjoining countries though they also import these ores even from North America, Latin America as well as from several African countries.

As far as East European countries are concerned, their total imports of iron ores are made from the USSR. During the last

few years, under bilateral trade agreements, about 7 per cent of their requirements have also been supplied by India. But India has not been their traditional supplier and so far only *ad hoc* imports are made from her. It is only Japan which has been diversifying her imports of iron ores and in this process India has substantially gained.

Exports of Indian iron ores have been increasing rapidly. In 1960-61, 3 million tonnes of iron ores were exported which increased to 12 million tonnes in 1965-66 and 13 million tonnes in 1966-67. About one-fifth of total requirements of Japan is met from India, but it may be noted that Japan imports about 85 per cent of her requirements from six countries in South-East Asia and nearly 15 per cent from six countries in North and South Americas. All imports in Japan are good quality ores carrying 55-70 per cent of iron and being free from phosphorus.

Indian ores contain about 64 per cent of iron, and though her output has been only 2 per cent of the total global production, yet on the basis of confirmed deposits, there is no apprehension either regarding quality or the availability of iron ores. High grade iron ores are produced in Sweden, India, Chile, Brazil, Venezuela, Australia as well as in certain African countries such as Sierra Leone, Union of South Africa and Spanish Morocco. Chile and Venezuela ores are of the same grade as that of India whereas those of Brazil are superior and they are in a favourable position to compete against Indian ores even in the Japanese market. The Indian expansion of iron ore exports would moreover involve making several significant adjustments. In some cases, there may be the desirability of beneficiation, in others provision of inland transportation, expansion of port facilities and arrangements for securing shipping space would be essential. The only favourable condition on which India can hope to expand her exports to the Japanese market is comparative cheapness of the ocean transportation charges but this has to be accompanied by other internal adjustments. In spite of these, India does not enjoy absolute superior-

city even at this centre of industrialization. India does not enjoy any monopolistic status here, and in fact, many other countries are better located to exploit even the Japanese market.

Advanced countries, as indicated earlier, do not depend on any other outside source exclusively for their iron ore requirement, many of them have their own developed iron mines. Even those countries which have been supplying the supplementary requirements of these advanced countries are better located than India with regard to ocean transportation. Therefore, the success of export promotion measures adopted by India would depend upon maintaining good political relations with Japan as well as with other advanced countries where iron ores could be conveniently transported. Africa, Australia as well as South American countries have favourable geographical locations which may give tough competition to India specially because India does not have her own adequately developed shipping industry.

Main Factors Influencing Indian Exports

We have seen above that the exports in any economy is a function of several factors. The level of national income, magnitude of industrial production, the spectrum of goods produced and the price at which they could be supplied, as well as the consumption level and its pattern are important considerations for evolving effective export promotion measures. Attention has also to be paid to the economic conditions prevailing in the importing country. As far as India is concerned, the persistent inflationary spiral and disturbing industrial discipline coupled with contradictory economic policies have created difficult situations. Unless radical measures are taken in order to vitalize the entire economy and establish healthy climate for personal initiative and for freedom of economic action, lasting progress in this sphere would not be forthcoming.

Economic advancement of India made under the various Plans has not so far made any significant dent on the export trade of the country. This is evident from an examination

of the Indian share in the expanding world trade. The increase in the relative share of machinery and light engineering goods has been only marginal. Unless the products in which India has comparative advantage begin acquiring an increasing share, permanent basis for boosting Indian exports cannot be established. Traditional items in which India has enjoyed superiority because of geographical and geological conditions would no longer provide much assistance. Other neighbouring countries having similar natural conditions but with better political climate have been showing signs of improvement in the world market. Therefore, a national consciousness for establishing an international standard of Indian manufactures should be cultivated without which the possibility for any permanent improvement would be dim. But this cannot be done merely by slogans.

Need for diversification in Indian exports has already been acknowledged. Presently, the Indian exports have been concentrated in a few commodities and to a limited number of countries. Such concentration, make the exports vulnerable to economic and political changes in international field. During recent years, exports to centrally directed economies have been increasing at the cost of exports to advanced West European countries. Because many of the articles exported by India are highly income-elastic, their market prospects should have been better in the West European countries but no serious attempt seems to have been made in this direction. In fact, the emphasis has been on the short term gains derived by exporting them to the Rupee Payment Countries in East Europe. The shift in the direction of Indian exports, to say the least, may not ultimately prove helpful.

Many of the developing countries which so far imported merchandise from India have now begun their own programmes of industrialization. As a result of this tendency, there have been import substitution schemes and import restriction enactments in those countries. These countries are also being assisted by several advanced countries. What previously could

have been advantageous for developing countries to import from India under normal trade practices may not be so under the impact of external aid shipments to them under various international assistance programmes. In this context the movement towards Africanization, Ceylonization, and other similar trends making the nations inward looking which protecting to local interests may also be noted as conditions restricting the expansion of Indian trade to those countries. The restrictive measures adopted by Ceylon necessitated by her own foreign exchange difficulties have caused strain on Indian exports there. The Ceylonese Government's Guaranteed Price Scheme instituted with a view to encouraging consumption of local items and conserving foreign exchange expenditures has reduced the Indian exports of subsidiary food items such as potatoes, chillies, green gram, Bombay onion, etc., to that country. The African and the Arab Common Markets have also reinforced the same trend.

China and Pakistan have begun aggressive campaign against the overseas Indian commercial interests. China and Pakistan have been reported to be offering to many African and Asian countries the supply of every article that India can make at a lower price with assured superiority in quality. Under economic assistance to Ceylon programme, China has exported to Ceylon agricultural products as well as industrial equipment including railway coaches which could have been easily supplied by India. Under a protocol signed in October 1964 between China and Afghanistan, it was stipulated that Afghanistan would export indigenously available items to China against imports of tea, building materials, stationery items and machinery from China. Furthermore, China has directly replaced the Indian merchandise traditionally obtained from India. The Afghanistan market has of late been overflooded with general merchandise and foodstuffs exported from Pakistan. China has taken vigorous steps to cut the sale of Indian tea in Sudan. She has more than doubled her exports to Kuwait where India had been traditionally

exporting tea, spices, coffee, travel goods, and footwear. In Ethiopia also, Pakistan and China have expanded their trade at the cost of Indian exports.

The external assistance programmes of advanced countries have also been adversely affecting the Indian exports. In this context, the example of Afghanistan has been significant. Afghanistan is a land-locked country with her national income accruing mainly from the production of fruits and other agricultural crops. During the last few years, many countries such as the USSR, Czechoslovakia, and East Germany have shown considerable interest in supplying the requirements of Afghanistan. The USSR has started exporting bicycles, cotton textiles, gasoline, petroleum products, vehicles, and machinery to this country. The leather tanning and rubber footwear factory in Afghanistan has been equipped with external aid from Czechoslovakia. The equipment for the telecommunication system located there has come from West Germany. Similarly, even in Nepal, where India has traditional relationship, the interest shown by a large number of international powers to the political and strategic importance of that country has added to the strain on the Indian exports to Nepal.

The Indian businessmen have lately been acquiring disrepute for their inefficiency and for not adhering to international business morality. There are many forms of this complaint. This defect is gradually being removed. What is expected to be eliminated by preshipment inspection is merely one form of this general complaint. It must be recognized that the trading relations are built over a long period. But there have been many complaints during recent years against the Indian business dealings. Often it is reported that the Indian businessmen have not complied with the regulations of international quality control, or that they have failed to adhere to the supply schedule promised or that they had delayed remittances of business commissions, or that these businessmen had not been maintaining uniform price quotations and the international

buyers had to spend much time in finding out the minimum Indian price below which they had not been selling to others. These have been very annoying to overseas buyers. Many trivial incidents often destroy well-established international markets. For example, the Indian mushrooms which once had practically enjoyed monopoly of the Swiss market lost ground because of the refusal by the Indian shippers to get their shipment quality tested by the Indian agents of the Swiss importers.

Another difficulty to the Indian exporters has been the general trend towards blocification. The advanced countries have been clubbing together for safeguarding their own interests. The European Common Market, and the European Free Trade Area have been important examples in this regard. These blocs have been working out details of tariff preferences for protecting their own markets and for safeguarding the interest of their associates. Political associations such as the European Socialist blocs with their special predilections to trade only with countries having similar political affiliations or with those which have strategic importance have further rigged the expansion of the Indian external trade. The underdeveloped countries themselves have added to this trend. The Latin American countries, the African countries, the Arab countries have all organized common markets of their own. These blocs have helped these regions to develop to a considerable extent but they have certainly put difficulties against such countries which do not belong to any specific group. These difficulties have been further accentuated by foreign exchange controls and restrictive legislations promulgated almost in every developing country.

Conclusions

What could India do to overcome her difficulties is not easy to suggest. This is an intricate problem involving reorganization of her internal economy and reorientation of her foreign relations. But this also requires a different set of conditions prevailing in international sphere. Over most of these factors,

India has very little control. The only task that she can set before herself is to put her own house in order. In this context, it will have to be noted that each export item has its own special problems. In order to tackle them it may be useful to set up an Export Commission with wide ranging powers. This Commission should have two wings, one responsible for research and economic planning. This requires reorganization of many governmental agencies/departments presently preoccupied with this problem. The second wing should be concerned with executive functions. Such organizations as State Trading Corporation, Metals and Mineral Trading Corporation and similar other organizations should be brought under the jurisdiction of this Commission. But the success of such a Commission would depend upon the general economic policy of the country and on the objective assessment of the situation prevailing abroad. India can hope to improve her share in the world market only when a comprehensive and radical approach to her exports is attempted.

CHAPTER V

IMPORTS

ONE OF THE important problems during the process of economic transformation is to minimize the strain on balance of payments. Imports of capital equipment and industrial raw materials at a time when exports have not been expanding smoothly create acute difficulties. For this reason, import-saving and import substitution schemes assume importance. There is, however, a danger that import savings might reduce the very tempo of development and an indiscriminate import substitution could increase the import bill substantially. Professor G A D MacDougall has been right in suggesting that indiscriminate efforts to produce everything might lead to serious economic troubles. Uneconomic search for import substitutes might weaken the economic structure of the country. In fact, the problems relating to imports, import substitution, strain on balance of payments and indigenous production for self-sufficiency are delicately related ones which should be tackled with greatest care and objectivity.

Planning and Imports

The Indian imports have been under critical scrutiny ever since independence. In the early years it was with a view to overcoming the shortages created by Partition. Subsequently, when planning began in India the primary objective had been to reduce foreign exchange strain without endangering the tempo of industrial production. Since 1957-58, when the foreign exchange crisis became acute, import trade control has become very severe. Since the Chinese aggression in 1962 and the Pakistani invasion in 1965, the defence outlay with enormous foreign exchange component has very much increased. This has made significant dent on the Indian economy. Imports for developmental and other purposes have, therefore, been drastically reduced. This tendency has been

further accentuated due to the recent drying up of foreign assistance to India.

In spite of careful planning with regard to imports, the situation has always remained disturbing. The total import bill has been increasing rapidly. The total imports (according to exchange control data) which amounted to Rs 520.1 crores in 1947-48, and Rs 603.9 crores in 1949-50, and Rs 650.3 crores in 1950-51 increased to Rs 1233.6 crores in 1957-58, Rs 1350 crores in 1964-65, Rs 1408.5 crores in 1965-66, Rs 1885.6 crores in 1966-67, and Rs 2042.8 crores in 1967-68. This clearly shows the magnitude of problem.

Pattern of Imports

The pattern of Indian imports, as it would be seen from Table 1, has been changing in favour of capital goods imports. Imports of capital goods have increased from Rs 99 crores in 1947-48 to Rs 167 crores in 1951-52, Rs 310.5 crores in 1957-58, Rs 576.1 crores in 1966-67, and 496.3 crores in 1967-68. During the early stages of Indian economic development, as it is natural to expect, imports of different kinds of machinery and transport equipment significantly increased, but presently, the need for such imports has been declining. Intermediates and raw materials required for augmenting industrial production are, however, increasing in importance.

Imports of raw materials and intermediates have increased from Rs 186.9 crores in 1947-48 to Rs 348.2 crores in 1950-51, Rs 490.7 crores in 1951-52, and Rs 563.8 crores in 1957-58; in 1960-61, these imports accounted for Rs 523.2 crores and in 1967-68, for Rs 870.7 crores. There has not been any uniform trend in this category of imports: there have been serious fluctuations in their value. In this connection, 1951-52 has been an important year. Since then, the course of Indian imports has not been smooth. This can even be inferred from Table 1, which shows the changing pattern of Indian imports. Till 1956-57, the year of foreign exchange crisis, the imports of raw materials and intermedi-

TABLE I
CHANGING PATTERN OF INDIAN IMPORTS
(In percentage of total imports)

<i>Year</i>	<i>Consumer goods</i>	<i>Capital goods</i>	<i>Raw material and intermediates</i>
1947-48	35.8	22.3	41.9
1954-55	24.7	20.5	54.8
1955-56	19.9	28.7	51.4
1956-57	13.8	29.8	56.4
1957-58	15.5	30.0	54.5
1958-59	27.6	29.0	43.4
1959-60	23.3	29.1	47.6
1960-61	23.7	29.7	46.6
1961-62	17.0	33.6	49.4
1962-63	19.1	34.6	46.3
1963-64	15.5	35.7	48.8
1964-65	25.5	35.4	39.1
1965-66	27.0	34.9	38.1
1966-67	35.9	27.7	36.4
1967-68	30.8	25.1	44.1

ates had been increasing, but later on, these imports were subjected to severe restrictions and as such, any significant trend in them cannot be inferred during this period. Most of the items included in the import list were examined individually and their essentiality in relation to production programme in the country scrutinized before granting permission for their importation. Fluctuations in imports of different items, in fact, have been connected with changes in priority assigned to the production programme of different products.

Imports of capital goods consist of mainly three categories of merchandise, namely, machinery other than electricals, electric machinery, and transport equipment. These imports were of the order of Rs 99.0 crores in 1947-48, Rs 167.0 crores in 1951-52, Rs 310.5 crores in 1957-58, Rs 333.0 crores in 1960-61, and Rs 496.3 crores in 1967-68. Imports of capital goods have been influenced by the expanding indigenous production programme of different items, foreign collaboration arrangements as well as by external assistance authorized by different nations.

A detailed examination of import data would indicate that the imports of foodgrains, fertilizers, iron and steel and manufactures thereof, non-ferrous metals, and machinery have substantially increased. Such items of imports as jute, cotton, staple fibres, dyeing, tanning and colouring materials, medicinal and pharmaceutical products, on the other hand, have declined. Important import savings have occurred in respect of (a) agro-based industrial raw materials, (b) certain categories of chemical formulations (as distinguished from the manufactures of basic and intermediate chemicals), and (c) metal manufactures of various types. As against these, imports of (a) foodgrains, (b) basic metals and manufactures thereof, (c) capital goods, (d) basic chemicals and intermediates, and (e) certain raw materials for export oriented industries have significantly increased.

Significant Causes Influencing the Trend

In order to discuss the important causes for this trend, it would be relevant to mention in this context the setting up of such "impact projects" as three steel plants in the public sector and substantial expansion of those in the private sector, and petroleum refineries, which induced "spread effect" in creating short-term increases in imports with a view to attaining self-sufficiency in the long-term.

During the course of the Second Five Year Plan, the Planning Commission assigned a crucial role to industrial expansion with special emphasis on industries. Import substitution schemes, which were made possible by the setting up of the three steel plants of one million ton ingot capacity each in the public sector at Bhilai, Rourkela, and Durgapur, and the completion of the modernization and expansion programmes of Tata Iron & Steel Co., and Indian Iron & Steel Co., in the private sector which added an additional 1.5 million tons of steel ingot capacity, very much modified the pattern of Indian imports.

Similarly, the setting up of the three petroleum refineries in the private sector and the two in the public sector has sub-

stantially augmented the indigenous production of many petroleum products. At the commencement of the First Plan, practically the entire demand of the country for petroleum products was met by imports, as the output of Assam Oil Company's refinery at Digboi hardly amounted to 0.4 million tonnes, accounting for less than 5 per cent of the national requirements. With the setting up of the two oil refineries of Standard Vacuum and Burmah shell at Trombay which were commissioned in August 1954 and January 1955, respectively and the Caltex Oil refinery at Vishakhapatnam which went on steam in April 1957, the domestic petroleum refinery capacity by the end of 1957 increased to 4.28 million tonnes. With the commissioning of the Nunmati and Barauni oil refineries in the public sector, the indigenous refining capacity increased by another 2.75 million tonnes. Later on, the private sector oil refineries were also allowed expansion programmes.

These oil refineries led to a substantial measure of import substitution in respect of petroleum products. Imports of crude petroleum entered for the first time in India's import trade in 1955-56, but consequently sizeable reduction occurred in respect of imports of motor spirit, diesel oil, kerosene, and lubricants. Besides, indigenous refining also provided the base for setting up a large number of petrochemical industries. The coal-tar derivatives made possible by the development programme of steel industries further encouraged the expansion of chemical industries in India, which previously had to depend mostly on imported sources of supply.

Agricultural development in India, with appropriate emphasis on increasing domestic food production as well as agro-based industrial raw materials has created, on the one hand, need for increasing imports of various items such as fertilizers and agricultural machinery, while on the other hand, it has led to substantial import substitution in regard to such industrial imports as tobacco, cotton, jute, etc. Attainment

of self-sufficiency has been an acknowledged policy with regard to food production in the country, but imports of the same have been increasing. Imports of foodgrains accounted for only Rs 28.90 crores in 1955-56 as against Rs 238.40 crores in 1960-61, Rs 309.10 crores in 1965-66, and Rs 518.2 crores in 1967-68.

Self-sufficiency in this respect required that fertilizers and agricultural machinery essential for intensive and improved means of cultivation are made available to the country. Imports of fertilizers (manufactured) have, consequently, increased from Rs 1.06 crores in 1955-56 (in 1947-48, Rs 4.6 crores worth of fertilizers were imported which had increased to Rs 12.3 crores worth of fertilizers in 1950-51), to Rs 38.90 crores in 1965-66; crude fertilizers increased from Rs 1.18 crores in 1955-56 to Rs 5.92 crores in 1965-66. Imports of fertilizers and fertilizer materials in 1967-68 amounted to Rs 204.7 crores as against Rs 81.4 crores in 1965-66. Similar increases have occurred even in the case of tractors and agricultural implements. These imports have taken place when their indigenous production has also been increasing.

Data on fruits and vegetables show that in 1955-56, the value of their imports accounted for Rs 11.20 crores which increased to Rs 20.39 crores in 1960-61 and Rs 22.70 crores in 1965-66. During the last so many years, the domestic production of fruits and vegetables has also been increasing. The increases in imports of this category of items have, however, been due to several bilateral trade agreements under which India has agreed to import these items in lieu of her own exports of manufactured items to those countries.

As a result of increased availability of basic metals, engineering activities have greatly developed in the country. Indigenous production of capital goods has also substantially increased. Nonetheless, in view of increasing demand for these items under the impetus of developmental planning, their imports have also been increasing. An important feature

of capital goods imports has, however, been gradual switching over from unsophisticated simple types of machinery to highly complicated and improved varieties of the same.

Mention in the present context may also be made of the great impetus given to the setting up of automobile industry in India. As a result of the encouragement given to indigenous units, the domestic production of commercial vehicles has increased from 32,200 in 1955-56 to 70,740 in 1965-66, the number of motor cycles increased from 1,550 to 25,040 and of bicycles from 663,970 to 1,631,000 during the decade. Imports of automobiles, motor cycles, and bicycles have been almost eliminated. As a result of this order of increasing indigenous production, a large number of automobile ancillary units have also been established within the country. Production of many complicated parts has been undertaken in India. Indianization has gone to a great extent, and presently, only a few critical parts are imported from abroad.

Development of automobile industry has, however, increased the demand for rubber products to a great extent. Automobile and bicycle tyres and tubes (besides rubber footwear to a very limited extent) consume almost the entire amount of synthetic, reclaimed and natural rubber available in the country. Domestic production of natural rubber has been increasing, but there have been geographical and other difficulties in this regard. Indigenous production of rubber has not been able to meet the increasing domestic demand. Imports of crude rubber, therefore, had to increase. In 1947-48, imports of crude rubber accounted for less than Rs 20 lakhs which in 1950-51 and 1951-52 due to abnormal circumstances accounted for Rs 3.0 crores and Rs 2.5 crores respectively, otherwise, till 1955-56, when the programme of indigenous production of automobiles was initiated, imports of crude rubber were not very high. Once the automobile industry alongwith motor cycle and bicycle manufactures got into stride, imports of crude rubber increased substantially reaching a level of more than Rs 10 crores for almost every year of the Third Plan.

The growth of automobile industry leading to increased availability of passenger cars, commercial vehicles, and trucks which has led to substantial expansion in road transportation, and the dieselization of railway locomotives have increased the demand for petroleum products. Industrial expansion, as well as agricultural development with the increasing use of tractors and diesel engines have further added pressure to this category of demand. In this context, it may be remembered that kerosene still serves as domestic fuel in a large number of Indian homes; in rural areas as well as in many towns kerosene is still extensively used for the lighting purpose.

The setting up of the petroleum refineries has considerably increased the indigenous availability of motor spirit, diesel oil, kerosene, lubricants, bitumen, etc., and has thereby reduced the imports of these items. But, the production pattern of petroleum refining has certain rigidities due to which the availability of diesel oil exceeds the domestic demand whereas motor spirit and kerosene have been in short supplies. These items have, therefore, to be imported from abroad. Thus, the import pattern of petroleum products has been changing.

Significant changes have occurred in regard to chemicals and chemical preparations too. During the last decade or so, imports of such items have been declining. The decrease has, however, not been for every item included under this category. Imports of chemicals had increased from Rs 9.3 crores in 1947-48 to Rs 70.6 crores in 1949-50 which showed the impact of the Korean war. Subsequently, the level came down to Rs 9.8 crores in 1950-51, but presently, it has been of the order of Rs 43.40 crore in 1965-66 as against Rs 23.03 crores in 1955-56. But, for certain categories of chemicals, such as, sodium hydrosulphate, sulphuric acid, bleaching powder, soda ash and calcium carbide, imports have been declining, whereas for others, as in the case of caustic soda, the imports have risen. Such trends can be explained in terms of the increasing domestic availability. A significant example has been of plastic raw materials,

whose imports at first increased but later on, it subsided.

Generally speaking, there has been a shift towards importation of basic raw materials and intermediates; final preparation and formulations are being indigenously carried out. Imports have also declined in the dyeing, tanning, and colouring materials: in 1947-48, these imports amounted to Rs 18.0 crores, which declined to Rs 11.1 crores in 1949-50 but by 1954-55 they again increased to Rs 19.3 crores, but in 1965-66 they accounted for only Rs 6.58 crores. Imports of medicinal and pharmaceutical products which in 1947-48 accounted for Rs 9.5 crores increased to Rs 16.5 crores in 1956-57, and Rs 17.2 crores in 1957-58 but they declined to Rs 8.76 crores in 1965-66. Evidently, the programme of development of chemical industries, and the indigenous manufacture of medicines and drugs have begun yielding results. Variations in the pattern of imports clearly show the impact of growing domestic demand in several directions and of the increasing efforts towards import substitution with consequential increases in imports of certain other related products.

Direction of Imports

The direction of Indian imports has significantly altered during the last twenty years. It may be worth its while examining whether this change has occurred due to increasing number of foreign collaborations or due to the impact of external assistance. We do not propose to do that here. In the present context, however, it may be mentioned that at the time of independence, the United Kingdom supplied 46.7 per cent of Indian imports and the United States 28.8 per cent. The proportion of East European countries was negligible at that time. Since then, the share of the United Kingdom has dropped to 8 per cent in 1967-68, and that of the United States has increased to 39.1 per cent.

Spectacular growth has occurred in the case of imports from the East European Socialist countries. This group having rupee payment agreements with India has increased its imports from

Rs 2 crores in 1947-48 (of which Czechoslovakia alone accounted for Rs 1.7 crores) to Rs 203.01 crores worth of imports in 1967-68. Imports from the USSR accounted for Rs 30 lakhs in 1947-48 which increased to Rs 95.82 crores in 1967-68. The direction of Indian imports has been abundantly modified by the availability of external assistance. The quantum of foreign aid coming from the United States has been colossal. The East European countries have special trade agreements. Consequently, the balance has moved in favour of these countries.

Import Trade Control

Import trade control has been very stringent in India. The programme of import substitution with increasing facilities to indigenous production has certainly relieved the balance of payments strain to some extent. The increasing tempo of industrialization, on other hand, has added to the import requirements of the country. Under its impetus, India's import bill has been increasing. The direction of imports has, however, changed from such traditional suppliers as Commonwealth countries to the United States of America and the East European countries. This has happened due to the authorization of foreign aid under various types of agreements, such as P.L. 480 and Rupee Payment agreements from these countries.

CHAPTER VI

AGRICULTURAL DEVELOPMENT

IMPACT of agricultural development on the industrialization process of a country is immense. But, the contribution of this sector is often overlooked. This happens because agriculture is primarily a way of life inextricably interwoven with the social life of the community. Its identification as a distinct and significant sector of economic operation, as is the manufacturing sector has been difficult. For a balanced growth of the economy, an appropriate coordination between agriculture and industry is vital. The integration between the two sectors, however, does not come "easily, quickly, and automatically."¹ Deliberate efforts have to be made for the same. An understanding of the main features of agriculture may be helpful in this regard.

Main Characteristics of Agriculture

Agricultural operations should not be considered radically different from other sectors of the economy. In many ways, it is similar to the manufacturing sector, but in several other ways it is different from that. The main difference between the two arises from the large application of land in the case of agriculture: land, which is the most important factor for agriculture, is by far, "larger in relation to its employment of other factors than does industry." In all manufacturing concerns, even when certain factors of production are "indivisible," they are subject to changes in the proportion of their application, and this can happen in a significant manner.

In agriculture, the limitations imposed by land are important. The relative significance of different factors of production may vary in different types of cultivation, none-

¹Theodore W. Schultz, *The Economic Organization of Agriculture*, McGraw-Hill, N. Y., 1953, p. vii.

theless, the supremacy of land is not challenged. It is around the factor land that all others gravitate. Application of fertilizers, introduction of large-scale mechanization, changes in land-holdings and special arrangements for irrigational facilities and pest control might radically change the nature of agricultural operations, but they do not minimize the significance of land. These factors are applied *to land*.

In other sectors of manufacturing activities the entrepreneurs have to be organizers with a gift for *coordinating* different factors of production whereas in agriculture, the farmers have to understand the nature of their land. And because land is an immobile factor of production, the farmers have to live with it. In manufacturing sector, almost all factors of production can be physically transported from one place to another. This cannot happen in the case of agriculture. Agricultural development would only imply putting additional inputs to land, doing intensive cultivation by making maximum use of the area and introducing variations in the pattern of cultivation with a view to adapting cultivation with the fecundity of the land.

Agriculture is not land but it is inextricably related to land. A corollary from this characteristic of land is that the social policy with regard to land should be adjusted in such a way that land occupies the central position in rural life. In such a pattern of the society, any programme for improving the lot of the people must be accompanied by arrangements which open out the possibility for expanding the scale of operations and intensification of cultivation. Only with such programmes, the rural community can hope to enrich itself and thereby, give impetus to the development of other sectors of the economy.

While considering the nature of land and the limitations imposed by this factor of production, one should however note that all plots of land are not identical. Considerable differentiation has taken place between one plot and another. This has been partly due to human ingenuity and partly due to climatic and geological conditions. The type of land signified by the kind of soil it has got, the climatic zones in which

it is located, and the various other natural surroundings in which it exists, would determine the different types of crops that can be grown on such plots. As a result of this constraint, the different plots are not interchangeable: each region is specialized to a considerable extent, making it suitable for a particular type of cultivation. Any strategy for agricultural development would, therefore, require that this characteristic of land differentiation is taken into account before deciding the particular use it can be put to, and the yield that can be expected from it.

Joint-Productness in Agriculture

It is also true that on various plots of land many different types of crops can be grown simultaneously. Professor Cohen has emphasized the characteristics of joint-productness of agriculture.³ In other manufacturing establishments, each undertaking is specialized and they produce only one or related varieties of the output. But in agriculture, it is not so. While sowing land or while putting it to different uses, it is hardly that only one category of product is expected from it. According to Professor Cohen, agricultural products are almost always joint-products, "either like wheat and offals, or mutton and wool because they are both part of the same plant or the same animal, or like barley and sheep because they are frequently produced most cheaply on the same farm." The cost attributable to various products, therefore, cannot be separated.

In a manufacturing establishment, because of the single product possibility, the cost estimate of different units of production is possible, while in agriculture because of this joint-productness, it requires special estimates for determining the cost involved in raising a particular output. It has, therefore, been suggested that the supply of any product in the agricultural sector should not be considered in isolation. As a

³R. L. Kohen, *The Economics of Agriculture*, Cambridge University Press, Cambridge, 1957, p. 2.

result of this situation, no land should be assumed as producing any item exclusively: each plot of land, evidently always yields more than one product.

No Unique Input-Output Relationship

In manufacturing establishments, it is possible to have a uniform level of production programme and adjust it in order to suit the decision of the management. This is not so in agriculture. No amount of human ingenuity can assure any particular level of agricultural production. The vagaries of nature play an important role. The response of land to technological improvements either by way of mechanized farming, chemical fertilization, assured irrigational facilities, improved cultivation method, or introduction of better seeds would not assure any unique relationship between the input and the output. In industrial enterprises, the level of output can be programmed *a priori* and inputs for the same can be mobilized. But, this cannot be done as far as agriculture is concerned.

This distinction is vital as far as agricultural planning is concerned. Different kinds of experiments have been performed in order to test the efficiency of different agricultural inputs, but none, so far, has been able to decide conclusively the relationship between varying doses of inputs and consequential increase in the yield. Agricultural yield depends on many economic, climatic and human factors over which human control has been impossible. The projection of supply curve for agricultural yield will, therefore, always be an area of possibilities rather than an exact point.

Indeterminate Price-Output Relationship

Price-output relationship for agricultural crops cannot be determined with the same assured confidence as in the case of manufacturing enterprises. Input-output tables can very accurately lead to production programming in industrial units. But in agriculture, this cannot be so. Impact of advance pricing, whether as in the case of minimum assured price for a

crop or procurement price in a State, at a pre-determined level, will not be effective in assuring a particular level of output available in the market. The reaction of the farmers to different prices differs according to varying circumstances. The agricultural farming, therefore, will also be influenced by factors other than price inducement. This does not imply that prices do not have any impact on farmers' psychology and on their decisions regarding putting different areas of land under different crops, but it implies that the prices are not the only incentive for the farmers. Many other considerations intervene to influence the farmer's production decision.

Experience has taught the farmers that a clever producer should not put all his eggs in the same basket. Because the output of agriculture depends considerably on weather and other factors which are beyond human control, the farmers make calculations of such uncertainties and decide about the security which they can obtain by diverting the land to different crops. In spite of protective measures, it is possible that an invasion of locusts would completely wipe out the fruits of the labour of the agriculturist. A drought would frustrate his expectations; on the other hand, a good monsoon might bring a bumper crop without much effort on his part.

One may, however, note that a good and abundant harvest in one State may not be accompanied by similar yield in another. A good and timely rainfall in Haryana may not be accompanied by similar precipitation in other parts of the Punjab. Such being the vagaries of the nature, the supply function of agricultural products could always elude human planning. Therefore, it is always in the interest of the farmer, and he is conscious of his responsibility, to cover his risk by cultivating such crops which may cover the loss in one by gains in the other.

A Way of Life

Professor Cohen has very rightly emphasized that agriculture is a way of life rather than merely a sector of economic

activities. In fact, wherever a large number of people settle down in order to carry out certain similar types of enterprises, they evolve a particular way of life of their own. In agriculture, however, there is a difference. The cultural pattern that grows in an agricultural community is unique in many ways. In this pattern, almost all aspects of the society have a centripetal tendency, converging on the proximity of man to nature (land).

Professor Cohen has rightly stated that "agriculture is often regarded as a way of life as well as a means of livelihood, so that sociological, political, and sentimental considerations influence its organization more than that of other forms of activity."³ As a result of this integration, the problems of agriculture becomes complex; agriculture requires not only the tackling of its commercial problems, but it also demands sociological approach to its development.

Essential for Men and Industries

Even as far as demand conditions are concerned, the agricultural sector of the economy is significantly different from the manufacturing sector. This is so, because of the very nature of agricultural output. Agriculture produces such basic requirements as food for human beings, and such industrial inputs as cotton, jute, rubber, and hides which are essential for a large number of industries. (Minerals are also, sometimes, technically considered under the term 'Land,' but in the present context, we might exclude them from our consideration.)

Essential foodstuffs and basic raw materials are vital for the well-being of the community and the development of industrial undertakings. But, the demand for these articles does not grow in the same proportion as national income. Their relative significance declines with the growth of the economy. It is true that the significance of industrial raw materials does not diminish in the same proportion as that of foodstuffs, nonetheless, the agro-based industrial raw materials

³*Ibid.*, p. 3.

do lose their relative importance. There have been many causes for the same. The growing importance of chemical substitutes for agro-based items and the increasing level of sophistication raising the degree of capital intensification have been reducing the importance of agricultural outputs.

Professor Cohen has also suggested that "the demand for agricultural products will increase less rapidly than that for industrial"⁴ because agriculture is mainly concerned with the production of food, which is the basic necessity of life, whose demand does not grow at the same rate as the rise in the standard of life made possible by improving the technique of production. For this reason, the study of agriculture is the study of an industry growing less rapidly than other branches of economic activities.

The Difficulties in Storage

Storing agricultural products, specially foodgrains, is much more difficult than storing the manufactured items. It is primarily so because the agricultural products are perishable. But, there have been other reasons for the same too. Small farmers have limited storage facilities; the large-scale arrangements for storing the products grown by small farmers induce the beginning of co-operativization which changes the very complexion of rural life. Even then, it cannot be denied that the storage of food products requires special granaries, arrangements for bulk handling of grains, facilities for germicidal sprays, and many other such provisions. These operations are very specialized. They require heavy expenditure and special training. Such special arrangements cannot be entirely left to individual (small) farmers. It, becomes therefore, necessary for the government to intervene, and to make necessary arrangements for providing storage facilities.

Furthermore, government has special responsibilities with regard to the provision of essential foodstuffs to its people. The question of buffer-stocks becomes important in this context.

⁴*Ibid.*, p. 4.

But, unless adequate storage facilities are created, it would be difficult to build buffer-stocks, and in absence of it, demand and supply forces cannot be appropriately matched. This would lead to frequent fluctuations in agricultural prices. Such instability would have far-reaching repercussions. Such eventualities do not arise in the manufacturing sector. Every industry has adequate storage facilities; the industrial goods are (generally) durable; and by regulating the production programme, inventory accumulation and the flow of output in wholesale and retail sectors, the industrialists can regulate the market prices to a great extent.

These lead us to conclude that agricultural operations, though a means of supplying final consumer goods as any other enterprise in the manufacturing sector, are radically different from the latter. It is obvious that the main complexity arises due to the serious constraint imposed by land, but other factors, such as instability of the agricultural yield which no amount of human ingenuity can regulate, inelastic demand for agricultural products, storage difficulties and many other such factors create special problems. As a result of these features, the agricultural sector of the economy has to be treated in a special way, particularly during the process of economic planning.

Declining Importance of Agriculture

In essence, economic growth is a matter of reorganization of the available factors of production with a view to removing the dead wood from the economy so that favourable conditions for fast development-impetus can be created. It requires structural change. Income-capital ratio of the capital stock has also to increase. It also requires that the technological changes representing once for all improvements for raising the production capacity of the economy are completely absorbed in the economy. As a result of such growth process which makes the community grow and attain higher levels of living, the relative significance of the different sectors

of the economy also changes. The manufacturing sector in this process gains importance; and many factors of production are reorganized and transferred from the agricultural sector to the growing manufacturing sector. These changes necessitate several consequential adjustments, which gradually reduce the relative importance of agriculture.

One does not have to emphasize too much, the shrinking role of agriculture in a growing economy. Professor Theodore W. Schultz has even emphasized the declining preoccupation of the economists with agricultural problems as an indication of this trend.⁵ The fact that the Physiocrats gave supreme importance to land which could not hold its central position with David Ricardo and it reconciled itself to a minor role under Karl Marx shows how correct is the observation of Professor Schultz. The Physiocrats did not only give a leading role in their analysis to land, but made it "hero of their scheme." The *Tableau Economique* has been an account of the circulation of agricultural yield accruing from land.

During the period of David Ricardo, land began to be considered as a constraint on the growth of the economy: the limited availability of cultivable land seriously impeded the fulfilment of growing demand for the agricultural output. Therefore, Ricardo and his British contemporaries gave land "a key role, but made it the villain of the piece." The Physiocrats believed in the abundance of nature, whereas David Ricardo and his followers thought of "niggardliness of nature" which placed land owners in a strategic position in a community with rapidly growing population.

The position further changed under Karl Marx. For Marx, "the existing landlords became a special species of capitalists of feudal vintage but obsolete, and therefore, soon to be replaced by genuine industrial capitalists." Again, land was cast as "the unmitigated villain" by Henry George who saw it as the instrument for transferring unearned social increment due to economic progress to landlords. Professor Schultz has even

⁵Theodore W. Schultz, *op. cit.*, p. 139.

mentioned in this connection the fact that Sir Roy Harrod while analyzing the conditions of dynamic economics even thought it better to discard it altogether because in "our particular context" it appears that its influence may be quantitatively unimportant.⁶ In fact, it is worth considering why and in what sense agriculture declines in significance.

At the outset, it may be indicated that the level of expenditure on agricultural products diminishes with rising levels of income. During the early phases of growth, when agriculture plays an important part, a large bulk of personal expenditure has been on agricultural items. The process of industrialization, however, brings about radical alterations in the expenditure pattern of the community. In an advanced community, the level of income is high and the percentage of expenditure on manufactured items greater. It has been stated that the level of expenditure of most households in England during the time of David Ricardo on food was very high—almost the entire income was spent on food articles—but this proportion gradually declined giving much greater importance to manufactured items at the time of Industrial Revolution.

During the period of Sir Roy Harrod, expenditure on agricultural crops attained a very low priority, comprising almost an insignificant proportion in an average well-to-do family. In fact, higher the level of economic development, lower the importance of agricultural outputs. When the economy attains the High Mass Consumption Stage, the different varieties of articles entering abundantly in the family budget of the household would still further reduce the importance of agriculture. Bertrand Russell has visualized that the natural peas, during the Scientific Age of future, would only be a luxury item intended for the well-to-do families, and the common man would derive his nourishment only from synthetic stuffs. The process of industrialization, evidently, introduces

⁶Roy Harrod, *Towards a Dynamic Economics*, Macmillan, London, 1948, p. 20.

new patterns of consumption, new substitutes for natural industrial inputs and new importance to different occupations. As a result of these changes, the significance of agriculture would inevitably decline.

In the present context, it is also relevant to note that the advance of science and introduction of modern technology in economic activities would reduce the dependence of the individual on nature and make him more reliant on his own ingenuity for satisfying his wants. As a result of this process of development, Professor Schultz is rightly inclined to think that the changes in production possibilities relative to the output of farm productions would determine the relative position of agriculture. If the improvements incorporated in producing non-agricultural outputs and services as a result of technological changes are such that the increase in agricultural yield is relatively less than of all other products and services, naturally agriculture will be adversely affected by such developments, but in case, increases in the output of farm products are more than those of other products, the situation becomes the reverse. This suggests that the importance of agriculture may not always decline with technological innovations, which is at least, a possibility to be acknowledged.

It has been experienced that the industrial progress opens out new frontiers of economic intercourse. International marketing, standardization of products as well as product differentiation resulting from mass media advertisements, introduction of research and technology, sophisticated packaging, and canning industry and all other activities which go with industrialization, would alter the importance of different sectors of the economy. It has been found that agricultural wages all over the world, as compared with industrial wage-rates, are lower; instability in total agricultural earnings due to fluctuations in yield and prices makes the dependence of labourers on agriculture a matter of second choice. Therefore, in spite of the fact that the agricultural sector still supplies the basic articles for the existence of human beings as well as for the

sustenance of several basic industries, the relative importance of agriculture has been declining with the increasing tempo of industrialization.

Contribution of Agriculture to Industries

The above, does not imply absence of any positive contribution of agriculture to the industrialization process of the country. Though many advanced countries consider agriculture as merely supplementary to the general programme of industrial development, yet examples are not wanting to indicate the dependence of the latter on agricultural prosperity. Dr S.R. Sen has rightly indicated that agricultural development contributes to the industrial development by way of (a) increasing the gross national product; (b) supplying the physical surpluses required by other sectors of the economy in the shape of food and raw materials; and (c) providing the economic surplus which constitutes the material basis for economic development.⁷ A group of experts from O.E.C.D. has also reported that agriculture can contribute to the growth of developed countries by increasing efficiency of production and releasing resources to other sectors and by adjusting the composition and scale of output to demand.⁸

Continuing and substantial adjustments in agricultural technology, in the structure of the industry, and in the composition and cost of farm output are, in the long-run, the basis for agriculture's contribution to well-balanced and rapid growth in the economy. When agricultural development takes place, it is reflected in increased output, or in reduced resource requirements or a combination of both. The amount released from the agricultural sector can very appropriately be invested in the industrial sector. In fact, development of agricultural sector is not synonymous with economic backwardness, as it is often associated in many minds. Examples are not wanting to

⁷S. R. Sen, *Strategy of Agricultural Development*, Asia, Bombay, p. 3.

⁸*Agricultural and Economic Growth, A Report by a Group of Experts*, O.E.C.D., Paris, 1965, p. 23.

show that predominantly agricultural countries have also been highly economically developed. West Indies, New Zealand, and the Netherlands are primarily agricultural countries, but they also enjoy a high standard of living.

Development of agriculture would enable other sectors of the economy to draw their manpower requirements from the surplus created in the agricultural sector. This happens in two ways. Firstly, the natural increase of population is usually greater in farm sectors than in non-farm sector. Even if the farm population remains constant, the natural outflow of manpower from the farm sector would make larger outflow of manpower to non-farm occupations. Secondly, with progress and mechanization of agricultural operations, the manpower requirements of this sector progressively diminish. This further adds to the outflow of labour from agriculture to non-agricultural occupations.

Capital formation is also substantially assisted by agricultural development. Agriculture accounts for a substantial percentage of national income in most of the developing countries. When scientific cultivation is adopted and other methods of improved agricultural operations introduced, yield from the agricultural sector considerably expands. This provides greater saving potential. Part of the savings thus generated might be channellized for agricultural improvements, but part of it is also mobilized for industries and other developmental requirements. In this process, however, it has to be assured that appropriate institutional and other arrangements for mobilizing the savings thus created are available. This emphasizes the need for greater monetary discipline and better financial institutions. These are important organizational pre-conditions which should be created in order to mop up the savings created in the agricultural sector.

Contribution of agriculture to the general developmental strategy would, to a considerable extent, depend upon the growth of other sectors of the economy. It may be possible for agriculture to increase the level of agricultural output,

create surplus manpower and make available saving potential for its appropriate utilization in other sectors of the economy, but they would be wasted in absence of corresponding expansion in other sectors. Favourable conditions for fruitful absorption of these resources must also be present in other sectors. There is mutual interdependence between farm and non-farm sectors of the economy. Consequently, when the surplus created in agriculture is appropriately absorbed in non-agricultural sectors, it would further encourage agricultural development. Expansion in non-farm sector would provide outlet for the products of agriculture, and for employment of labour displaced from land. Moreover, creation of better employment opportunities in the economy would also induce upward pressure on wages. Increased wage-rates in agricultural sector would provide greater incentive for those who remain on land to work harder and to improve their productivity. Technological improvements in other sectors would make conditions favourable for the introduction of improved means of cultivation and mechanization in agriculture. Establishment of financial institutions would be helpful for industrial as well as agricultural sectors of the economy. Above all, when the tempo of industrialization and the rate of growth of economic development increase, a new environment of expectancy and improvement is created which is less tradition bound and more conducive to innovations, generation of higher managerial skill and greater investment in human resources. Such a change is highly propitious for agricultural development as well.

Necessary Preparations

There are many rigidities which have to be softened in order to facilitate the transition of traditional agricultural community into a modern industrialized economy. The most serious impediment in this connection arises from the organizational pattern of agriculture. We have mentioned earlier that the agricultural occupations are characterized by the fact that agriculture is primarily a way of life, and as such, the problem has

to be tackled at economic as well as non-economic levels. As (agriculture is usually the oldest sector of the economy,) often characterized by a distinctive pattern of life and organization, one finds that life in such communities is intimately attached to land; there have been small units of operations combining property, management and labour; all or most of the family members have been engaged in agricultural pursuits and these communities have often been isolated from the urban foci of economic growth.

All these characteristics create obstacles to an easy transfer of properly trained and educated labour to other growing sectors, to an adjustment of production to changing demand, to changes in scales and structure of farm units and to the movement of capital out of agriculture. Such obstacles must be removed in order to vitalize the agricultural sector and to enable it to share in the gains of economic development. These changes can be possible by removing many non-economic objectives of agricultural development and enlightening the people with regard to those objectives.

Unnecessary emphasis on small land-holdings, ceilings on land which are not conducive to mechanization and improved methods of cultivation, and uneconomic protection to farmers and thereby providing premium to inefficiency and uneconomic practices have often retarded the growth and development of the agricultural sector. These create social and economic problems in moving labour out of this sector. Unless the enterprises are made viable, larger capital investment encouraged, and gains of large-scale farming assured, the problem of agriculture cannot be effectively tackled. Primogeniture has advantages in arousing the spirit of adventure and enterprise; sub-division and fragmentation of land, division of the holdings between a large number of sons and daughters, and the fixation of small area-ceilings are not conducive to agricultural development.

The other major difficulty in fostering initiative and enterprise in the agricultural sector has been connected with agricul-

tural prices. Three main types of price relationships have to be tackled in the present context. These relate to (a) price relationship between individual farm outputs; (b) price relationship subsisting between different agricultural inputs and the prices of the resulting products; and (c) the relationship existing between the general prices of agricultural products on the one hand and the prices of other non-farm products on the other. These adjustments are difficult but they have to be made.

It is natural and desirable for the farmers to make adjustments following the price changes so as to maximize their profits. Relative price-differentials between different crops should induce the agriculturists to change over to the crops yielding the maximum return. But, such adjustments are not always possible. There is always a time-lag between the decision to cultivate any specific crop and the final yield of that crop; this time-gap has often been so wide as to change the entire future expectation. Furthermore, (the farmers do not have much freedom in changing the crop: there are limitations of land by which only certain selected crops can be grown on any specific plot of land, although when the prices rise, the farmers may wish to move to better paying crops.)

The degree of specialization has not been very high in agriculture and the labour cost has been almost the same for different types of crops (here we are not thinking of the difference between vegetable gardening and crop farming), therefore, the changeover to better paying crops would be a matter of climatic and geological conditions rather than of wage differential. Here also, the calculation is not based on precise marginal costs and marginal revenues: the farmers are mostly induced by rough calculations of their *expected* gains and risks involved in total failure which may occur due to weather uncertainties or marketing difficulties. The farmers are unable to extend their cultivation up to the economic optimum because of institutional and structural rigidities indicated earlier. He cannot alter at will the size of his land-holdings either. But these difficulties do not completely wipe out the tendency towards

adjustment: the prices do exert considerable influence on farmers' decision as to what to produce and in what quantities.

When there is variation in the relative prices of different agricultural inputs, such as fertilizers, in relation to the prices of those items of production which are responsive to such inputs the farmer is faced with much more complicated situations. In a paper, O. P. Gugnani of the Planning Commission has tried to amplify some of these difficulties.⁹ In this context, he has distinguished between technical optimum and economic optimum and has suggested that the farmer would attempt to reach the economic optimum rather than technical optimum. This is primarily due to the input price and the price of the yield resulting from the same. He has further suggested that the inducement for persuading any farmer to co-opt for any particular line of production would depend upon a while range of prices of different inputs as well as of different competing crops in different regions. From this, it may be seen that the agriculturists have to reckon with the whole gamut of prices prevailing and expected before he could decide his line of action.

Evidently, agricultural operations have distinct characteristics distinguishing them from other manufacturing activities, but both are interdependent to a great extent. The agricultural sector has to adjust itself with changing requirements and influences of industries, but such adjustments become difficult due to institutional, structural, technical, economic, and social rigidities.

Agricultural Development in India

Indian agriculture has lent only limited support to Indian economic growth. It happened so not due to any administrative apathy. The Indian planners, in fact, accorded the highest priority to this sector of development. The main reason for this feeble impact of agriculture has been the structural weakness of the economy and the organizational deficiencies created by

⁹O. P. Gugnani, *Economics of High Yield Varieties*, A Paper presented at a Seminar at the Institute of Economic Growth, New Delhi, 1968.

unpragmatic socio-political objectives. Furthermore, the course of agricultural development did not lay appropriate emphasis on geographical factors: in this context, it may be mentioned that political events have also accentuated the regional imbalance. Geographically, South and South-East Asia is one homogenous bloc whose solidarity could give it immense concentration of strategic industrial raw materials and sufficient level of food production. Balkanization of this area has led to considerable deterioration in its economic balance. The separation of Burma in 1936, and the partition of the Indian subcontinent in 1947, for instance, have seriously impaired the Indian capacity to produce enough foodstuffs for sustaining her population. Jute production and its manufacture have been jeopardized due to Partition. Similarly, it could be indicated that the close relationship between India, Pakistan, Ceylon, Burma, Malaysia, Thailand, Indonesia, the Philippines, and others of this region could greatly strengthen their bargaining capacity with regard to tea, jute, mesta, lac, tin, mineral oil, coffee, rubber, and many other such internationally traded commodities. Even with regard to food, the situation could have been substantially better.

The Indian planning authorities recognized the vital importance of agricultural development for the supply of raw materials to industries and provision of foodstuffs to the people, but the difficulties facing this sector of the economy have been numerous and complicated. There was no unique way to tackle these problems. Rationing of foodstuffs and sharp fluctuations in agricultural prices had emphasized the urgency of the problem. The people were getting restless. Moreover, the rapid development of industries also increased the demand for agricultural products. Therefore, the significance of agriculture increased considerably for supplying foodstuffs and industrial raw materials.

During the First Five Year Plan, the highest priority was accorded to agriculture. Assistance to agricultural development was imparted in twofold manner: firstly, organizational improve-

ments were attempted in order to raise the level of agricultural efficiency, and, secondly, many rural development schemes for building infra-structure and, creating better living conditions for the farmers were implemented. The reorganization of agriculture required necessary preparations by way of provision of such agricultural inputs as fertilizers, improved seeds, agricultural implements, and irrigational facilities. Rural population had to be organized for co-operative action with a view to enabling it to make better use of new knowledge and new resources. Reforms in land-tenureship in order to abolish unproductive intermediary rights in various States had to be implemented.

(Development of related markets so that commercialization of agricultural products could be possible on a wider scale, and building up of institutional credit organizations and agencies which could meet the financial requirements of the agriculturists were also important planks of agricultural development in the country.) In order to improve the rural living conditions and activate rural industrialization, the First Five Year Plan initiated the programmes of Community Development, Panchayati Raj, and several others aiming at elimination of differences in rural life and provision of greater opportunities for diversified activities. These programmes were expected to integrate rural communities in a well-organized structure of national planning.

As a result of the several programmes of agricultural development initiated during the First Five Year Plan, substantial increases were expected in agricultural production of food-grains as well as of other commercial crops. Emphasis was placed on increasing the yield of cotton, jute, sugarcane, and oilseeds. The targets for additional production envisaged in the First Plan with regard to some of these items have been as follows: foodgrains 7.6 million tons showing 14 per cent increase over the 1949-50 level of 54.9 million tons, cotton 1.26 million bales showing an increase of 42 per cent during the plan period, jute 2.09 million bales (63 per cent increase),

sugarcane 0.7 million tons in terms of gur (12 per cent increase) and oilseeds 0.4 million tons accounting for 8 per cent increase. The target of 7.6 million tons of additional foodgrains roughly consisted of 4 million tons of rice, 2 million tons of wheat, one million ton of grams and pulses, and 0.5 million tons of millets.

Large-scale investment was necessary in order to implement the agricultural programme of this order. It was therefore stipulated that Rs 361 crores, accounting for 17.5 per cent of the total plan outlay, which was of the order of Rs 2,069 crores, would be earmarked for agriculture and community development, Rs 168 crores or 8.17 per cent of the total plan outlay on irrigation projects, Rs 266 crores or 12.9 per cent on multi-purpose irrigation and power projects and Rs 127 crores or 6.1 per cent of the total plan outlay on power. These accounted for 44.6 per cent of the First Plan outlay. This shows that the high priority to agricultural development was accompanied by adequate financial provision for the implementation of the programme.

During the Second Five Year Plan, attempts were made to intensify the efforts made during the earlier quinquennium. Generally speaking, no new strategy was introduced during this period, nonetheless, the heartening results obtained during the First Plan period suggested some modifications in the emphasis. It was no longer necessary to place a dominant emphasis on the production of cereal crops; the cash crops such as sugarcane, oilseeds, tea, coffee, tobacco, and black pepper gained in importance. Important emphasis was also placed on achieving increases in the production of fruits and vegetables. (Diversification of production, optimum utilization of the available area of cultivation, and maximum yield of the cultivated crops were the chief objectives of this sector of development.) The development programme of this sector was conceived within a long-term perspective of a ten-year programme.

The principal targets of agricultural production for the

Second Five Year Plan were set out as follows:

TABLE 1
PRODUCTION TARGETS OF MAJOR AGRICULTURAL ITEMS

<i>Commodity</i>	<i>Unit</i>	<i>Estimated production in 1955-56</i>	<i>Target of additional production</i>
Foodgrains	million tons	65.0	10.0
Oilseeds	million tons	5.5	1.5
Sugarcane (gur)	million tons	5.8	1.3
Cotton	million bales	4.2	1.3
Jute	million bales	4.0	1.0
Coconut (oil)	lakh tons	1.3	0.8
Areca nut	lakh maunds	22.0	5.0
Lac	lakh maunds	12.0	4.0
Tobacco	lakh tons	2.5	—
Black pepper	thousand tons	26.0	6.0
Cashew nut	thousand tons	60.0	20.0
Tea	million pounds	644.0	50.0

SOURCE : *Second Five Year Plan*, Planning Commission, New Delhi, p. 262.

The total plan outlay during the Second Five Year Plan in the public sector was programmed for Rs 4,800 crores, of which Rs 568 crores, or 11.8 per cent was allotted to agriculture and community development, Rs 381 crores, or 7.9 per cent for irrigation, Rs 427 crores, or 8.9 per cent for power, and Rs 105 crores, or 2.2 per cent for flood control and other related projects. These allocations have been exclusive of credit facilities made available from various institutional agencies. Though the total outlay on the above developmental heads accounted for only 30.8 per cent, which has been a little less than the percentage share during the First Five Year Plan period, in absolute quantity the outlay on these heads increased from Rs 922 crores in the First Plan to Rs 1,461 crores during the Third Plan period.

Reaffirming the need for intensified agricultural development, the Third Five Year Plan proposed to carry out the programme already initiated much further. Programmes for agriculture, irrigation, and community development included in the Third Plan entailed a total outlay of Rs 1,718 crores as

against an estimated expenditure of Rs 950 crores over these items in the Second Plan. These programmes aimed at nearly doubling the rate of growth of agricultural production over the next five years. Production of foodgrains was expected to rise by 30 per cent and of other crops by 31 per cent. The target for additional foodgrains production was set at 24 million tons, cotton 1.9 million bales, jute (excluding mesta) 2.2 million bales, coffee 32 thousand tons, tea 175 million lbs, rubber 18.6 thousand tons, tobacco 25 thousand tons and of lac 12 thousand tons.

Such targets were worked out for most of the important agricultural crops and even the input requirements for achieving these targets were assessed in greater detail. It was stipulated that the agricultural programme envisaged under the Third Plan would require intensive efforts with regard to (i) irrigation (25.6 million acres), (ii) soil conservation, dry farming, and land reclamation (36.8 million acres), (iii) additional area under improved seeds (foodgrains) (148.0 million acres), (iv) supply of chemical fertilizers constituting nitrogenous (N) fertilizers 1,000 thousand tons, phosphatic (P_2O_5) 400 thousand tons, and potassic (K_2O) 200 thousand tons, (v) plant protection (50 million acres), and (vi) better ploughs and improved agricultural implements and adoption of scientific agricultural practices. Necessary arrangements for the manufacture of agricultural implements had also to be finalized for attaining the targets laid down.

Mention, in the present context, may also be made of the Intensive Agricultural Districts Programme and the Village Production Plans. Under the former programme, an intensive effort was made to increase agricultural production in selected areas where, on account of the availability of irrigation and assured rainfall, conditions seemed favourable. At least at one place in each district such intensive work had to be carried out during the plan period. Co-operatives, Panchayats, and other village organizations were expected to play an important role in this programme.

Village Production Plans involved all cultivators in the village.

This scheme consisted of two sets of activities. It included provision of credit facilities, fertilizers, improved seeds, assistance for plant protection and minor irrigation facilities. The other set of conditions referred to the programme of digging field channels for utilizing irrigation facilities arising from large projects, maintenance of bunds and field channels, contact bunding, digging and maintenance of village tanks, village fuel plantation, etc. These activities required co-ordinated efforts on the part of the entire community or groups of cultivators. Both sets of programmes had to be worked out in close collaboration with Panchayats, co-operatives, and other rural institutions. The Panchayats could visualize the plan for the entire village and mobilize co-operative efforts from all the beneficiaries whereas the village co-operatives could arrange for financial assistance to individual cultivators.

Realizing that the performance of the Third Five Year Plan had been "disappointing," the Draft Outline of the Fourth Five Year Plan (1966) pointed out that the "top priority" for agriculture could not be meaningful and effective merely by bringing together the various targets and programmes relating to agriculture, rather it was imperative that all other interconnected activities in other sectors of the economy were identified and given due preference. Consequently, the Draft Outline emphasized the need for ensuring adequate provision of appropriate material inputs and other supporting services which influenced and stimulated agricultural growth. Besides stressing the urgency of an integrated industrial programme for the production of fertilizers, pesticides, tractors, and other agricultural implements, it was also considered necessary to intensify the provision of irrigational facilities on a massive scale, to formulate a well-considered price policy, to arrange for appropriate marketing, storage, transport, and credit facilities, and to reorient rural institutions having important influence on agricultural development.

The Fourth Five Year Plan also envisaged the introduction of a new strategy, which consisted of taking some more vigorous steps besides Intensive Agricultural District Programme and the Intensive Agricultural Area Programme. The new strategy stressed the use of high-yielding variety of seeds and improved scientific methods of cultivation. Experiments conducted at different research centres on exotic and hybrid varieties of seeds have shown their responsiveness to heavy dosage of chemical fertilizers, particularly in areas of assured drainage facilities.

The new strategy also aims at introducing short duration crops having far reaching implications for the Indian agriculture. As a result of this programme, the production of such subsidiary food items as potatoes and other tubers would also increase. The production of pulses is also expected to increase. During the Fourth Plan period, special emphasis would be given on items having export potential. With this aim in view, the Draft Outline suggested special programmes for achieving substantially significant production targets with regard to such commercial crops as jute, groundnut, and tobacco. Jute cultivation would be encouraged in newly irrigated areas of Kosi and Hirakud. Cashew cultivation would be extended to another 4.5 lakh acres of land, and the production of pepper may amount to 5,000 tonnes by the last year of the Fourth Plan. The production of lac, which occupies an important position in Indian export trade, would be increased from 30,000 tonnes at the beginning of the plan period to 50,000 tonnes by the end of it. Administrative reorganization is also contemplated in order to facilitate proper co-ordination between different programmes.

The Fourth Five Year Plan as indicated in the Draft Outline did not begin in 1966-67. Instead of it, Annual Plans were prepared for three years and the revised Fourth Five Year Plan Draft began in 1969-70. Many modifications have been introduced in the agricultural plan, but its basic features, however, remain the same.

Assessment of the Impact

The progress achieved in the agricultural sector is difficult to assess. Under the impact of the three five-year plans, apparently, much development has taken place. To consider this impact as of limited significance might be considered provocative. A scientific evaluation of the progress achieved in this sector would require much objectivity and examination from various aspects. Here, we would study the contribution of agricultural development on the economic growth of the country from the following standpoints: (i) pressure on land, (ii) supply of foodgrains, (iii) assistance to industrial development, (iv) impact on foreign exchange earnings, (v) resources for the Plan, and (vi) rural development.

Pressure on Land

More than 69.5 per cent of the total working force in India earns its livelihood from agriculture. More than half the national income of India is derived from agriculture and allied activities. Out of every three workers in India, two are engaged on land, whereas in the United Kingdom for every single person engaged in agriculture more than fourteen work in mines, manufacturing and construction activities. The primary impact of agricultural development should be on the reduction of dependence of Indian population on land, and consequently, on reducing the pressure on land. It would incidently increase the earning capacity and raise the living standard of agricultural workers.

The available statistics indicate that the total reporting area in 1950-51 amounted to 284.3 million hectares which increased to 299.8 million hectares in 1962-63 showing increased coverage for 15.5 million hectares, but during this period, area under forests has increased from 40.5 million hectares to 56.7 million hectares indicating an increase of 16.2 million hectares. Though there is no justification for assuming increased forest area to account for increment in reporting area, yet on this assumption, one would find

that the area of uncultivated land other than fallow land decreased from 49.5 million hectares in 1950-51 to 37.1 million hectares in 1962-63, and fallow land decreased from 28.1 million hectares to 20.9 million hectares over the period, thus, additional land put under cultivation accounted for 19.6 million hectares. The net area sown increased from 118.7 million hectares in 1950-51 to 137.9 million hectares in 1964-65. The existing area was even better utilized; in 1950-51, only 13.2 million hectares of land was sown more than once, but in 1962-63, the area increased to 19.9 million hectares showing an increase of 6.7 million hectares being sown more than once.

During the last twenty years or so, the increase in net area sown has not been sufficient to reduce the pressure of population. While the net area sown increased from 118.7 million hectares in 1950-51 to 137.9 million hectares, population increased from 361.09 million in 1950-51 to 486.99 million in 1964-65. This gives per capita availability of cultivated land of 0.33 hectare in 1950-51 and 0.28 hectare in 1964-65 showing 15 per cent decline over the period.

Even if we consider the total cropped area, the position does not improve much. In 1950-51, the total cropped area amounted to 131.9 million hectares which in 1964-65 increased to 158.1 million hectares showing a decline in per capita availability of cropped area from 0.37 hectare in 1950-51 to 0.32 hectare in 1964-65. Increases in irrigated area have occurred only recently; net area irrigated which in 1950-51 amounted to 20.9 million hectares increased in 1962-63 to 22.5 million hectares and in 1964-65 to 26.2 million hectares. Such increases have not been able to reduce population pressure on land in any significant measure.

Supply of Foodgrains

Output of foodgrains during 1967-68 reached the record level of 95.6 million tonnes, or 28.8 per cent more than the

rather than purely economic factors, have seriously impinged on agricultural prices. Farmers have been too much sheltered. National agricultural price has not emerged and the creation of food zones has been an important impediment in this respect. Minimum support prices, procurement prices, and many other types of controlled prices have provided disincentive to the agriculturists for economizing the cost of cultivation. These controls have provided premium to uneconomic cultivation. In several cases, they have even resulted in reduced food production and transfer to cash crops. Unrealistic agricultural price policy has failed to arouse among the farmers a sense of participation in the colossal economic programme of development.

The agricultural sector has, however, provided a large volume of industrial inputs. The growing volume of production of cotton textiles, jute manufactures, and sugar besides the increased production of tea, coffee, vanaspati, and similar other articles has been possible as a result of agricultural development. Area of cotton cultivation has increased from 4,926 thousand hectares in 1949-50 to 8,271 thousand hectares in 1964-65 and 7,827 thousand hectares in 1965-66 yielding 2,596 thousand tonnes of cotton in 1949-50, 5,664 thousand tonnes in 1964-65, and 4,708 thousand tonnes in 1965-66. Jute cultivation has increased from 471 thousand hectares in 1949-50 to 839 thousand hectares in 1964-65 though in 1965-66 the area under this crop declined to 748 thousand hectares; 3,114 thousand tonnes of jute were produced in 1949-50 which increased to 6,021 thousand tonnes in 1964-65 though its production declined to 4,985 thousand tonnes in 1965-66. In 1949-50, 50,173 thousand tonnes of sugarcane was produced which in 1965-66 amounted to 117,606 thousand tonnes. Similarly, the production of groundnuts increased from 3,481 thousand tonnes in 1950-51 to 5,888 thousand tonnes in 1964-65, but to only 4,022 thousand tonnes in 1965-66. Tobacco production increased from 261 thousand tonnes in 1950-51 to 346 thousand

tonnes in 1964-65 and to only 274 thousand tonnes in 1965-66.

These have been substantial increases. Significance of such increased agricultural outputs becomes clearer when these increases are compared with declining imports of those items. It has been estimated that the share of imports to total estimated supplies of raw cotton declined from 27.8 per cent in 1950-51 to 12.3 per cent in 1955-56, 16.4 per cent in 1960-61, 10.9 per cent in 1965-66, and 10.3 per cent in 1967-68. The share of imported raw jute declined from 35.1 per cent in 1950-51 to 21.6 per cent in 1955-56, 17.5 per cent in 1965-66 and 15.1 per cent in 1967-68. Imports of oilseeds, oilnuts, and kernels have also declined over the period. Almost the entire indigenous requirements of tobacco (excepting for a small quantity of specialized category) are met from domestic sources. These data indicate that the Indian agriculture, excepting in a few cases, as in the case of cashew nuts, has been increasingly meeting the raw material requirements of the growing Indian industries.

But, the co-ordination between agriculture and industries involves many other intricate relationships. Dr R. Thamarajakshi in her thesis *Agriculture-Industry Relationship for the decade 1948-49—1958-59* has tried to quantify the contribution of these sectors to each other. She has stated that the demand by the industrial sector for all agricultural products, whether in intermediate or in final use, i.e. the marketed surplus of agriculture products to the industrial sector alone, depicts a slowly rising tendency. During the decade under examination, the industrial demand for inputs from the agricultural sector has risen by nearly 2½ times, which clearly shows that the dependence of industrial development on agriculture has indeed been increasing.

Dr Thamarajakshi has further indicated that the percentage of total agriculture output marketed to the industrial sector alone has registered a rising trend, though of an imperceptible order. This substantiates the conclusion that the agricultural sector has increasingly, though not in a spectacular way as yet,

been contributing to the industrial development of the country.

With regard to the supply of labour released from the agricultural sector for employment in the manufacturing enterprises, the problem has not been as important in India as in many other advanced countries. Only when employment level has reached a high mark with little surplus workmen for new and expanding enterprises that the question of deployment of labour and the availability of surplus manpower becomes significant. In India, there already exists abundant supply of factory labour.

Dr Thamarajakshi, while analyzing the contribution of agricultural labour force to meet the requirements of the manufacturing sector, has suggested that there are two ways of doing so; firstly, there is the natural growth of population; and secondly, the rate of absorption in the agricultural sector itself might decline so as to release larger labour force for other activities. The first is related to general increase in population. But as far as the second is concerned, the agricultural sector of the economy has shown better utilization of the work force on land.

In the present context, the observation made by Professor M.L. Dantwala may also be relevant.¹¹ He has stated that between 1951 and 1961, there was an addition of 49.26 million persons to the number of "workers" in the country. The number of workers engaged in agriculture during these ten years increased by 33.92 million as against 15.34 million in other sectors, with the result that the ratio of workers engaged in agriculture has practically declined from 69.74 to 69.51. Professor Dantwala has further emphasized that the desirability of not adding to the number of workers engaged in agriculture in 1961 during the subsequent period, with the likely increase in population, would require the annual rate of absorption in the non-agricultural sector to be about 5.5 per cent. From this, it can be seen that the agricultural sector has not been an impedi-

¹¹M. L. Dantwala, "Agricultural Employment in a Developing Economy," *Readings in Economic Theory and Indian Agricultural Policy*, pp. 534-5.

ment in meeting the industrial requirements of working force. It has, in fact, been stated that the agriculture works as the "shock absorber" for seasonal, frictional, and technological unemployment generated in "non-agricultural" sector. Agricultural development in this way has much more "welfare content" than it is generally believed.

Impact on Foreign Exchange Earnings

During the course of economic development, there is great urgency to acquire a large amount of foreign exchanges. One way for doing so is to increase the exportable surplus. Agriculture has to play an important role in this regard, but the Indian agriculture has not as yet yielded satisfactory result. The country is not yet self-sufficient with regard to her food requirements. Imports of foodgrains have been increasing. P.L. 480 imports, which amounted to Rs 1,368.5 crores by the end of the Third Plan period, do not require immediate foreign exchange payments but under recent agreements, the transport charges have to be paid in US dollars. Thus food imports have been a drain on the country's foreign resources.

Imports of agricultural implements, tractors, and fertilizers have also been increasing during recent years. Imports of agricultural machinery and implements which amounted to Rs 7 crores in 1950-51, increased to Rs 10.02 crores in 1965-66 and Rs 11.93 crores in 1966-67. Imports of fertilizers increased from Rs 12.35 crores in 1950-51 to Rs 96.70 crores in 1966-67. These two items taken together amounted to 2.9 per cent of total imports in 1950-51, which accounted for 3.9 per cent of the total in 1965-66 and 5.8 per cent in 1966-67. This increase took place when the total imports have also been increasing. Evidently, agricultural development implies greater foreign exchange expenditure.

As against this, it may also be noted that the Indian exports of tea, coffee, oilseeds, cashewnuts, jute manufactures, sugar, and similar other items for which agriculture provided the basic material, have also been increasing. Exports of tea increased from Rs 80.42 crores in 1950-51 to Rs 180.2 crores in 1967-68.

Details of the agricultural exports are already given elsewhere and their difficulties have also been discussed there. Here, we may, however, indicate that the main difficulties have been mainly exogenous, though internal factors have also contributed in this regard. But, considering the overall position, it may be suggested that the agricultural development, in spite of its failing on the food front, has made substantial contribution towards foreign exchange earnings. The Indian exports even today, primarily remain agro-based, and the agricultural sector has adapted itself well to this task.

Resources for the Plan

How much the agricultural development has contributed towards the raising of the financial resources for the Plan is difficult to assess. By taking the three main sources of agricultural contribution, namely, land revenue, agricultural income tax, and the cess on sugarcane to the combined revenue receipts of Centre, State, and Union Territories, it may be seen that the agricultural contribution has been declining. The receipts from land revenue have increased from Rs 51.57 crores in 1950-51 to Rs 95.08 crores in 1967-68, the agricultural income tax rose from Rs 3.59 crores in 1950-51 to Rs 11.01 crores in 1967-68 and the cess on sugarcane during this period increased from Rs 2.16 crores to Rs 11.06 crores. The total contribution of these items to the total revenue receipts, however, declined from 7.2 per cent in 1950-51 to 2.6 per cent in 1967-68 implying that the relative significance of these items has been declining.

The expenditure on agriculture and rural development has been increasing under the impact of planned development. Taking development and non-developmental expenditures together, the level of such expenditures in 1950-51 amounted to Rs 29.31 crores which increased to Rs 401.48 crores in 1967-68. These figures may be confusing, but the fact that the level of expenditure on the agricultural (and rural) sector of the economy has been out of proportion of the total receipts from it cannot be disputed. This sector has, however, been mobilizing

a portion of its savings through the usual commercial channels such as, banks and co-operative societies, but that contribution has not been substantial. It is true that many agriculturists have begun investing in large-scale agricultural implement, manufacturing enterprises as well as in several fertilizer units, but the total of such investments has not yet made any impact on the national economy. It may, therefore, be concluded that the agricultural sector has received much more attention and national resources than it has contributed from its own savings. The need for channellizing the rural savings is great. Agriculture should not be the dumping area for the savings created in other sectors of the economy, which it has done so far.

Impact on Rural Development

Rural development, almost all over the world, hinges around the progress made in agriculture. In fact, "agricultural improvement is an integral part of the much wider problem of raising the level of rural life. The economic aspects of village life cannot be detached from the broader social aspects; and agricultural improvement is inextricably linked up with a whole set of social problems." It has already been indicated that agriculture is rather a way of life, therefore, any improvement in this sector must necessarily be reflected in the general improvement in the rural community.

This integral approach to the village life was acknowledged in India at the time of the formulation of the First Plan when it was stated that the "peasant's life is not cut into segments in the way the government's activities are apt to be; the approach to the villager has, therefore, to be a co-ordinated one and has to comprehend his whole life." For this very reason, many programmes were initiated during the First Five Year Plan which aimed at improving the conditions of agriculture expecting that other sectors of the village life would also consequently improve.

The Community Development Programme and the National Extension Services were initiated in 1952 with the same

objective. Under these programmes, it was hoped that the growth of agriculture would have profound impact on related industrial activities which might activize the rural economy. The Karve Committee recommendations for decentralization of industries in rural areas highlighted the vital significance of rural development based on agricultural prosperity. In 1956, 26 Community Industrial Pilot Projects spread all over the country were sponsored with a view to encouraging co-ordinated development of rural areas.

Another landmark in promotion of rural development has been the appointment of Rural Industries Planning Committee in 1962 by the Planning Commission. This Committee worked out a scheme of 49 Rural Industries Projects with a view to integrating agricultural development with rural industrialization and thereby eliminating underemployment in rural communities and providing better opportunities for the application of human and financial resources of the growing villages. None of these have, however, succeeded in making much impact on the rural living. Even the setting up of Rural Industrial Estates has had only feeble influence.

While explaining the approach to various programmes of rural industrialization, the Development Commissioner, Small Scale Industries, K. L. Nanjappa, has emphasized that "agriculture cannot be divorced from any consideration of industries. Agriculture is the basic source of livelihood for the rural people and its revitalization is of the utmost importance." Agricultural growth must induce agro-industrial development which could activize ruralization of a large variety of manufacturing activities and thereby raise the rural level of living. In fact, agro-industrial development and agricultural progress are mutually interdependent. "Whenever agro-industries are set up, there are signs of traditional methods of agriculture slowly giving way to modern techniques and knowledge." But, so far agro-industrial development has been in disarray.

It is not possible to quantify the impact of agricultural

growth on the development of rural industrialization. Rising agricultural prices, mechanization of agricultural operations, introduction of chemical fertilization, monetization of the rural sector, commercialization of agricultural surpluses, as well as the increase in educational facilities and improved transport connections should have begun a new life in Indian villages. Notwithstanding the general improvement in certain isolated areas of the country, a large section of Indian rural population still suffers from poverty, ignorance, and "unbalanced living." A transistor, a wrist-watch, and the nylon do not compensate for a better house, good furniture, nourishing food, and a good life. The main reason for this unbalanced living has been the inability of agriculturalists to have confidence in their rising prosperity. Farmers are aware that their prosperity is very much dependent upon the artificial buttress from the government and the vagaries of nature. Such gains cannot be channellized to those amenities of life which would regularly demand higher levels of expenditure. This goes to the root of rural problems. Agriculture has failed to activize the urge for a good rural life on a secure basis so that such activities which depended upon higher local consumption expenditure could be established there.

Need for a New Direction

During the last twenty years or so, much progress has been made in the sphere of agricultural development but much more still remains to be done. Unless a radical transformation is brought about in the agricultural sector, a large bulk of Indian population would remain in a pitiable condition. The living conditions of Indian village must change. The agriculturists must obtain appropriate share in the national cake. The share must be equitable, which implies that there should be perfect viability of the agricultural sector. The manufacturing sector should not permanently buttress the agricultural sector.

It is difficult to indicate the goal which should be attained in any sector of development. It depends on many factors. But no

sector should be a parasite on another. If an agricultural worker has been unable to produce output which could fetch the same price as that of a factory worker, his expectation of a wage rate equal to that of the latter may not be justified. No system of human organization has ever provided equal remuneration for all types of activities. If that happens, there would be chaos. Therefore, the agricultural worker and the factory labour will necessarily have different rates of remuneration. As such, there would be differences in their living standards. This is the first point which must be recognized and acknowledged at the very outset of agricultural planning.

There is, however, much scope for improvement in agricultural earnings. Israel and Japan have only 0.17 and 0.06 hectare of arable land per person as against 0.35 hectare in India, but their income from land has been as high as (US) \$562.50 and (US) \$1,055.28 per hectare respectively. These are earnings very much higher than those available in India. This shows that the possibility of raising the per capita earnings of Indian agriculturists has been much more than available so far. Indian agriculturists have been raising their productivity; their earnings have also been increasing. But, so far, they have enjoyed sheltered conditions. State patronage has been an important reason for their betterment. This should continue till they are able to stand on their own. But, twenty-year period is a long duration for any unnatural protection. Agriculturists must realize their obligations to the nation and begin throwing away their crutches.

One of the difficulties facing reorganization of the agricultural sector has been connected with the fact that agriculture is very much a way of living. Any legislation which affects the agricultural sector of the economy also influences the living conditions in rural areas. Therefore, socio-political enactments relating to land reforms, agricultural prices, and subsidies cannot be isolated from the economic consequences of the same. Fragmentation of holdings is harmful for large-scale mechanization, capital intensification, enterprising commer-

cialization, and for other activities which go to transform the agricultural economy.

From this standpoint, the law of primogeniture is much better than assigning inheritance right to every son and daughter. Fixation of (small) ceilings on land holdings may have social and political overtones, but it is undesirable from economic point of view. These are some of the examples to indicate the difficult nature of the decisions involved. It is dangerous to mix political and economic considerations when *national* prosperity is the objective. Social content of the rural uplift programme should be based on a level different from the economic content of the programme. Villages must improve, but creating permanent impediments in the process of economic prosperity may not be desirable. Many of the present schemes do not seem helpful. There are many ways of rural uplift, some of which might help agricultural development whereas others might retard its prosperity. Effort should be made to encourage the former and eliminate the latter.

Presently, in India, much emotion has been aroused about agriculture and rural uplift. Therefore, it is necessary that public opinion is created for an objective study of the agricultural problem. It may be helpful to raise the basic agricultural problems and discuss the repercussions of various legislations and enactments relating to them. The agriculturists must be educated about their opportunities, responsibilities, and difficulties. They should also be prepared by gradual withdrawal of protection to face the realities of market forces. But, this is, indeed, a difficult task.

CHAPTER VII

RURAL INDUSTRIALIZATION

PROBLEMS OF rural industrialization are difficult to comprehend and arduous to implement. Anyone who has been intimately connected with the task of Indian rural development would agree that the large-scale industrial plans intended for the country have not made any significant impact on the rural life. The desire to transform their village communities in order to enjoy the gains of contemporary technological achievements has not yet been aroused among the village folk. There have been many instances of several large-scale mechanized farms having been initiated for agricultural development, but their influence has been feeble in creating any social change. These developmental activities have failed to bring any radical change in the Indian village life.

Instances have occurred to show that the large-scale plantations using modern and scientific techniques have developed in the middle of a peasant farming area but they have not been able to create any "demonstration effect" on the neighbouring agricultural regions. The big industries also have not established any "industrial ladder" by which the necessary inputs like steel, fertilizers, and pesticides produced in an industrial area could be brought to small farmers even twenty miles away. These farmers have not been motivated to modernize their farming techniques either. These clearly suggest that the agricultural development has been, as it were, like an island nowhere integrated as a part of the area development programmes.¹

¹Presidential Address delivered by Dr S R Sen at the All India Agricultural Economics Conference held at Baroda in December 1959. Reproduced in *Strategy of Agricultural Development*, S R. Sen, Asia, Bombay, p. 10.

This shows that the existing kind of industrialization programme merely creates "enclaves"; it does not seem to initiate continuing growth process, specially in rural areas. This emphasizes the need for evolving a new strategy. The main difficulty in this regard arises from the neglect of the fact that rural industrialization is intimately connected with the rural life of the population. Any fundamental change in this direction can take place only by tackling the problems of rural life comprehensively. A new approach in this direction would be necessary. It is likely that a new theory of rural development itself may have to be evolved. It is not merely a problem of "regional imbalance," rather it is a question of new experimentation. Very few countries of the Western civilization have had any such experience. In this chapter, therefore, an attempt will be made to see whether the task of rural development can be tackled by emphasizing the role of any special type of industrial development in such areas.

There is no presumption on the part of the author to suggest that the answer to the question of rural development is agro-based industrial development. His primary objective has been to emphasize the importance of a new strategy to the problems of rural development. It is, however, expected that the development of agro-based industries in these areas might arouse the urge to industrialize, earn more, save more, and invest in newly establishing rural industries so as to derive larger share in industrial gains and thereby enjoy a better standard of living. This might make the peasants partners in the national development programme. As a result of this process, they might enthusiastically partake in the gains of overall development planning. Thus, a new developmental process could be initiated which might destroy the isolation of the Indian villages and eliminate them as isolated blocs of under-development.

Low Income-High Consumption Areas

Economists have agreed that the development of any area

would depend upon the investment resources mobilized for the region. These could be obtained either from the domestic resources or from the external sources. For any continuing growth process, the necessary resources must be generated in the region itself. Only in that case, the development of the area could be viable. But the rural areas are so much handicapped that they are unable to mobilize any substantial savings from their own incomes. Per capita income of the rural population is considerably lower than their per capita expenditure. As a result of this situation, there is nothing left with the villagers to contribute towards the developmental requirements of the region.

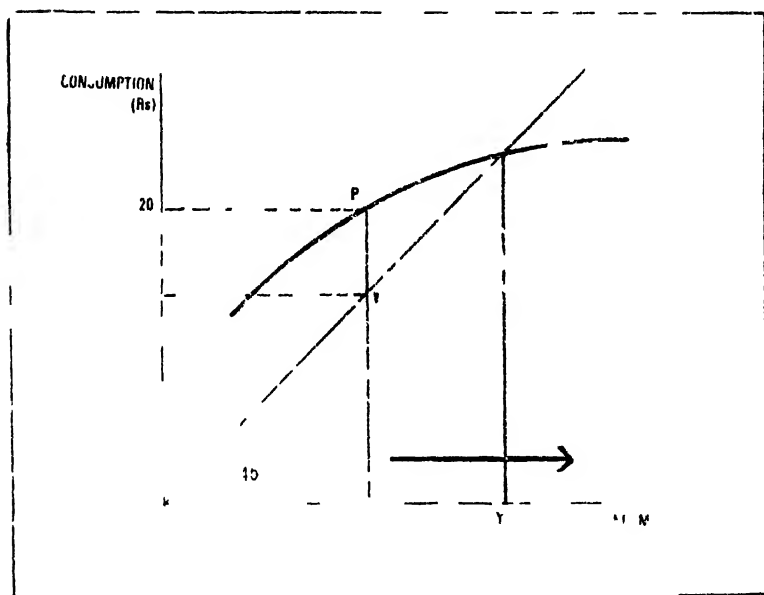
This conclusion has been challenged by many persons. It has been stated that the progress made during the last two decades in rural areas has been substantial and the rural population has also been able to invest in several important industrial concerns. This may not be disputed, but the fact that remains to be examined is that the rural areas in spite of their doing well are unable to earn adequate income for a decent living and in aggregate terms they earn less than what they spend on consumption items. Whether this gap represents the magnitude of rural indebtedness or not is a secondary matter in the present context. If the amount earned in the urban areas and remitted to village inhabitants has been spent by them on consumption items, this may substantiate the contention that the rural income is less than their expenditure on consumption.

From the rough and ready data it has been found out that the

²National Sample Survey 15th Round relating to July 1959 to June 1960 period gives Rs 20.03 as per capita rural monthly consumption expenditure. In 1960-61 net national product at factor cost amounted to Rs 14,140 crores of which 48.7 per cent came from agricultural sector which has been assumed as rural earnings. In 1961, there were 359 million inhabitants in Indian villages. On the basis of these figures, per capita monthly income of rural population would be Rs 15.9. This way of arriving at rural earnings and expenditure is very crude, but in the absence of any better data readily available this may serve the present purpose.

rural earnings give only about Rs 16 per individual per month whereas he spends about Rs 20 during that period. For the present purpose, the urban income made available to the rural population is not taken as rural earnings. Generally speaking, the following diagram representing the relationship between rural income and consumption expenditure can be considered applicable to most of the underdeveloped regions.

DIAGRAM SHOWING
RURAL INCOME AND EXPENDITURE



The above diagram shows the relationship between the levels of income and the consumption expenditure in rural areas. With increasing levels of income the marginal propensity to consume declines though the absolute quantum of expenditure may continue to increase. Until the income level reaches OY' , the individual would incur more expenditure than his income. The primary task of the rural economy is to obtain adequate amount of resources from the local sources which could be channellized for regional development programmes. If the

development has to be self-sustaining, it is necessary that the rural savings increased. This can happen only when the rural income is raised. First, the rural earnings should increase to the level OY' where the earning of rural inhabitants is equal to their expenditure on consumption items, and then, the earning should go beyond OY' so as to generate local saving potential. The relationship between PP' and YP' in some way indicates the impediment facing the region. In order to initiate viable growth in the region it is necessary to eliminate PP' completely. This can happen naturally when the earnings of the individuals are increased.

Consciousness of Regional Development

So far we have assumed that the monetary factors are important for activating the rural development process. Traditional economic analysis lays down that the availability of adequate levels of investment resources would be able to induce the growth process. But, it is not difficult to see the inadequacy of the above argument. If financial resources were the sole requirements of developmental activities, the amount of external (to the region) resources invested in the rural areas should have been able to create a new world of economic prosperity in these regions which has not so far taken place.

Experiences of the recent years have been suggesting that the real problem facing the underdeveloped regions has not been financial. There are many other dimensions to the problem. It is helpful to take into account other motivating factors and then evolve an appropriate strategy for the rural development programme. In this context, Professor Moriemon Ito of the Commercial University, Otaru, Japan has done a yeoman's service. Professor Ito has done a pioneering work in quantifying such non-economic factors and making them measurable.³ For the sake of better exposition of the problem

³Moriemon Ito, "Stages of Economic Growth and the Consciousness of Regional Development," *Dissemination of Knowledge Series*, No. 23, January 1968, Asian Productivity Organization, Tokyo, pp. 1-15.

in hand, it may be useful to indicate briefly the line of thinking of Professor Ito.

Professor Moriemon Ito has indicated that besides "such exterior bounties as capital and technology, there is considerable importance of political, social, and cultural factors." Therefore, he has suggested that the "stages of economic growth and policies followed accordingly should be determined in the correlations of the economic, political, social, and cultural factors for regional development.⁴ Success of these policies would depend upon the volition of the people which results from the inhabitants' consciousness for regional development. This consciousness can be positive or negative as indicated below:⁵

(+) <i>Plus</i>	(-) <i>Minus</i>
(1) Independence Consciousness	Dependence Consciousness
(2) Participation Consciousness	Indifference
(3) Superiority Complex	Inferiority Complex
(4) Open-Mindedness	Close-Mindedness

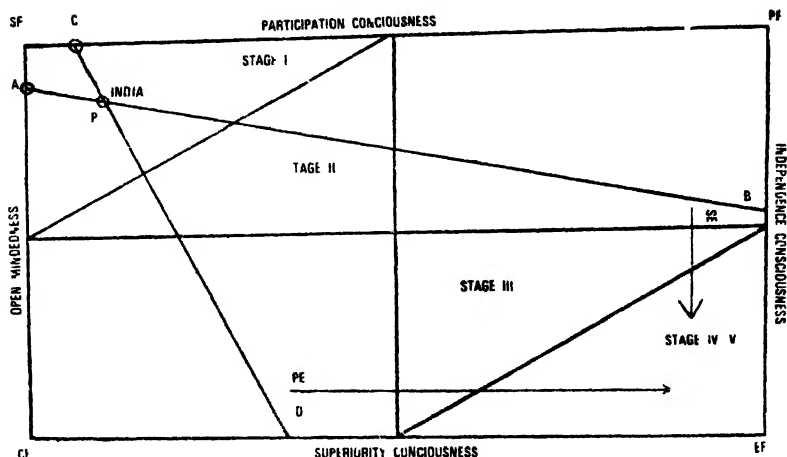
The four main factors of economic development and the four stages of social consciousness (with their plus and minus values) would represent, according to Professor Ito, a quadrilateral, not necessarily a rectangle, within which the stages of economic growth as suggested by W.W. Rostow can be easily plotted, as given in the diagram on the next page. This diagram would also be able to suggest what further non-economic or economic programme of action would be necessary in order to energize the developmental activities. The diagram, according to Professor Ito, represents the Indian situation. Arrows in it show what further actions are necessary for activating its growth.⁶

⁴*Ibid.*, p. 1.

⁵*Ibid.*, p. 3.

⁶*Ibid.*, p. 9.

DIAGRAM SHOWING THE RELATIONSHIP BETWEEN ECONOMIC AND NON-ECONOMIC FACTORS



In the above diagram, *SF* represents social factors, *PF* political factors, *CF* cultural factors, and *EF* economic factors. *PE* suggests primary emphasis and *SE* the secondary emphasis which would be needed for the required direction of regional development.

The aim of every programme of regional development is to approach Stage IV at a faster rate. It can happen when the intersection point *P* of the straight lines *AB* and *CD* moves from Stage I to Stage IV rapidly. The diagram suggests the forces necessary for inducing the regional economic development on the desired path. The degree of open-mindedness, which signifies how much the region is willing to absorb the developmental influences, namely, acceptance of outside technicians socially, integration of the output produced locally in their consumption pattern, etc., can be measured along the line *SF-CI*; proximity to *SF* suggesting close-mindedness. Participation consciousness refers to the cooperation and initiative of the local people in evolving programmes of development, etc., nearness to *PF* shows higher measure of the same.

If the people are ready to sacrifice their consumption and generate savings for local development activities, this could be measured along the line $PF-EF$. Similarly, when the inhabitants take pride in belonging to a particular area, higher degree of this attitude would take them from CF to EF . If these states of social consciousness are appropriately developed, the point P would correspondingly move from Stage I to Stage IV.⁷ For this movement, certain primary and secondary inducements are necessary; policy decisions relating to regional development should aim at providing those inducements.

In India, it has been suggested that the primary need is to improve cultural (technological) level through the fostering of superiority complex and participation consciousness with secondary emphasis on political factors with independence consciousness and open-mindedness. These would take the underdeveloped region from the stage of traditional society to that of take-off stage.

This, in short, is the summary of Professor Ito's approach to regional development. In Indian conditions, it seems appropriate to consider those forces to which Professor Ito refers to. This approach brings together political, social, cultural, and economic forces, and suggests how they could be mobilized for regional development. Experience has shown that all these forces have been operating on the Indian programmes of economic development. A comprehensive analysis of these forces however has not been possible here. What is attempted here is to show how best these suggestions of Professor Ito can be integrated with the programme of rural development so that it could energize the village economy in an effective manner.

Appropriateness of Agro-Industries

Most of the Indian villages have still been in the early stages of traditional society. In order to push them from that

⁷These stages refer to Professor W.W. Rostow's Stages of Growth, namely, Traditional Society, Preconditions for Take-Off, Drive to Maturity, Maturity, and the Age of High Mass Consumption. The last two stages have merged together in the present analysis.

stage to that of take-off and further to maturity, it is necessary to organize and mobilize non-economic as well as monetary factors in the most appropriate manner. Some lines of business activities are very suitable for this purpose because they permit the possibility of integrating all the four factors enumerated above for the development of the region. Establishment of agro-based industries in rural areas may be one such activity which could enable the village community to feel active about it.

Even the international experts have thought that the "rural villages and towns* have natural locational advantages for some agriculture-based industries and a few other types of industry not very dependent on urban economic advantages may also be successfully fostered there."⁸ But one must be cautious in this approach. In case due regard is shown to the appropriateness of technology and suitability of location, agro-industrial growth could induct non-economic factors as well as it might arouse adequate social consciousness for the rapid development of the area. The most significant advantage of agro-based industries has been its ability to break the frontiers of the "rural enclaves": agro-industrial establishments have great possibilities for integrating themselves in the socio-economic fabric of the rural community.

Generally speaking, agro-based industries include all those industries which obtain their major inputs from, or which primarily meet the requirements of agricultural sector, but this generic definition of agro-industries does not serve much practical purpose. According to this definition, all the textile mills located in Bombay could be considered as agro-based because cotton is an agricultural product, so would be the jute

*Rural villages and towns imply agricultural locations; in West many villages and towns are not necessarily agricultural. The phrase sounds odd in the Indian context, but it seems to have been deliberately used.

⁸*Report of the International Perspective Planning Team*, sponsored by the Ford Foundation, Ministry of Industry, 1963, p. 126.

mills located in West Bengal because they depend on jute, which is an agricultural product. That is certainly not the objective of this categorization.

In order to decide the industries which have relevance in the present context, a list of agro-based industries has already been finalized in consultation with the Planning Commission, Central Small Industries Organization, Ministry of Food and Agriculture, and the Ministry of Industrial Development. This list is divided in two parts consisting of (1) agricultural processing and allied industries, and (2) inputs required for agriculture, animal husbandry and fishery, etc. The first category includes (a) food products, and (b) non-food and allied products such as textiles and fibre industries, wood and timber products, and miscellaneous items such as bricks and tiles, tanning and leather products, fertilizer formulation and natural rubber processing, etc. The second category refers to (a) mechanical engineering products, agricultural implements, poultry farming equipment, slaughter house equipment, etc., and (b) pesticide formulation.

This list, in fact, is a huge one, but the guiding consideration in finalizing the list has been the inclusion of all those items which could be processed or fabricated in the rural or semi-urban areas with minimum assistance, either by way of importation of industrial inputs or of technical help from outside the region. Such fabrications, it is hoped, by providing employment opportunities in rural areas and thereby raising the levels of income would enable the inhabitants to consume a large proportion of the total output thus produced in the region. This in turn would again lead to increased effective demand for the agro-based as well as other outputs available there. Thus a chain reaction for activating a series of rural industries could be started.

It is true that the governmental assistance for the development of these industries may be necessary during their initial stages but this dependence on outside assistance, whether governmental

or otherwise, should gradually taper off. Whether this expectation remains merely a pious hope or succeeds in achieving the object in view would depend upon not merely careful selection of the right type of industries but also on several other economic and non-economic factors.

*Fitting Agro-Based Industries in
Standard Pattern of Industrialization*

The programmes of rural industrialization in India have not made much impact because the "Standard Pattern" of industrialization which usually follows the growth process in every country has been overlooked. The standard pattern of industrialization suggests that the three broad classes of industry that spring up as a country enters upon modern manufacturing have been (i) essential consumer goods, (ii) capital goods necessary for construction activities, and (iii) natural export industries.⁹ These industries generally depend upon locally available raw materials mostly of the agricultural origin; they also employ simple technology and modest capital, which lie within the reach of local inhabitants. It is only at a later stage that more sophisticated and complicated items of manufactures are produced. This description does not take anyone long to realize that the agro-industries of the type we have been discussing so far come at the very initial stage of the growth process.

While giving details of the standard pattern, George B. Baldwin has indicated that these industries which are incorporated at the initial stages of industrialization have horizontal, vertical and exogenous growth with forward and backward linkages as the society develops. The rationale of this course of development rests with the fundamental fact that all forms of business activities to be of the continuing nature must be related to the local resources and requirements of the people. That is probably the reason why Mahatma Gandhi emphasized the role of

⁹George B. Baldwin, "Industrialization: A Standard Pattern", *Finance and Development*, International Monetary Fund, Washington, Vol. III, No. 4, December 1966, p. 274.

natural consumption pattern and its integration with the production possibilities of the community.¹⁰

The standard pattern of industrialization, in fact, derives its sustenance from the basic needs of the people and natural linkages between different items of production. There is nothing "Western" or "Oriental" about such natural relations as many persons think. Because the generalization about this sequence of industrial growth is based on the natural principle, of economic development, it is not only imperative but even logical that all programmes of industrialization, whether in India or abroad, whether in rural areas or in towns, should be prepared after taking into account this generalization which, however, may have variations in details but not in its basic structure. Wherever the structure of development has been in consonance with the basic principle of this pattern of industrialization, encouraging results have been achieved.

For example, the Chinhat experiment of the *Planning Research and Action Institute*, Lucknow, has shown that the production of agricultural implements, rahat buckets, sanitary latrine seats, pottery items as well as textiles and readymade garments for meeting the local demand has been able to generate substantial investment resources. The Sangli complex of industries starting with the establishment of co-operative sugarcane crushing mill keeping in line with the standard pattern of industrialization, led to the growth of such diversified industries as industrial alcohol, paper and paper board, fibre board and furniture, etc., which in their own turn have assisted the emergence of groundnut processing units, hume-pipe factory, agricultural implement manufacturing units, leather goods and footwear manufacture and the production of pumping sets, etc.¹¹ These examples would suggest that the emergence of rural industries

¹⁰Bepin Behari, *Gandhian Economic Philosophy*, Vora, Bombay, 1963, pp. 54-8.

¹¹Bepin Behari, *The Role of Cooperatives in the Development of Agro-Based Industries in Sangli District*, DCSSIO, Ministry of Industry, 1967, Mimeographed.

should be in consonance with the natural pattern of industrialization, if they are expected to generate the multiplier effect to the desired extent. The question of standard pattern of industries, however, needs going into greater details.

Scale of Industry and Capital Intensity

In order to make agro-industrial development a success, it would also be necessary to consider in this context, (i) right choice of technology, and (ii) proper size of the enterprise. The technological choice involves difficult investment decisions. E. F. Schumacher has suggested that "the cost of work-place should be fairly close to the amount a man can earn in a year."¹² Many rural industrial estates have failed to enthuse rural entrepreneurship because the rents of these sheds have been "very high."¹³

A "high-technology factory" situated in a rural area may in fact generate income not for the area where it is located but mainly for the area from which it obtains its equipment and raw materials. ... If the existence of the "high-technology factory" in the rural area, through its apparently low-cost production killed off the locally established "low-technology" production of similar articles, the locality itself is actually impoverished.¹⁴

This is why the establishment of highly sophisticated industries in Chhota Nagpur or the highly mechanized large-scale plantations in Assam have failed to initiate developmental processes in the neighbourhood, whereas the small-scale units in the Punjab where more than 40 per cent of machine tools in the country are produced, whose industrialization

¹²E. F. Schumacher, "Reflections on the Problem of Bringing Industries to Rural Areas," *Appropriate Technologies for Indian Industry*, Small Industry Extension Training Institute, Hyderabad, 1964, p. 41.

¹³*Industrial Estates in India*, Development Commissioner, Small Scale Industries, Ministry of Industrial Development and Company Affairs, New Delhi, pp. 32-51.

¹⁴E. F. Schumacher, *op. cit.*, p. 34.

began on the availability of local talents for meeting the local agricultural requirements, have presently galvanised the entire State.

In the Indian circumstances, the advantages of small-scale units particularly for those items which are connected with agricultural requirements of the rural areas are so great that it has been found that even the setting up of pre-fabricated small-scale fertilizer plants has comparative advantages over the large units.¹⁵ In fact, the Japanese experience has also suggested that simple techniques should be used first and more complex ones introduced gradually.¹⁶ Whatever the level of technology, it should be such as to "induce a cumulative expansion" process. *No attempt should be made to jump over the intermediate stages of technological development* if the region aims at avoiding "in the midst of great poverty and a primitive way of life, a gleaming, streamlined new factory, created by foreign private enterprise."¹⁷

Technology adopted for rural industrialization should be such as to make full (or optimum) utilization of available local resources, otherwise the "rural population would be impoverished because a large part of the non-agricultural production would die away."¹⁸

Locational Constraints for Rural Production

Every industry cannot be established at all locations. In order to finalize the different items of manufacture that can be undertaken at different places, it is necessary that a comprehensive survey of the natural resources of the region is made for finding out the suitability of different agro-industries there.

¹⁵Phillips Foster and Dennis Wood, "The Case of Small Plants in India," *Development Digest*, National Planning Association, Washington, Vol. V, No. 2, April 1968, pp. 110-8.

¹⁶Saburo Okit, "The Experience of Japan and its Implications," SIETI, Hyderabad, p. 30.

¹⁷E. F. Schumacher, *op. cit.*, p. 31.

¹⁸*Ibid.*, p. 34.

Presently, data relating to agro-industries are very scanty. Office of the Development Commissioner, Small Scale Industries has made a study of agro-industries in nine Rural Industries Projects spread over in six States covering 444 units employing 4,689 persons and having assets worth Rs 2.44 crores. Shri S. D. Thapar has also mentioned certain categories of small scale industries which have comparative advantages over large-scale units.¹⁹ On the basis of output data, Shri Thapar has stated that "the small-scale industries would develop faster in industries like agro-based industries and non-metal based industries. ... Small-scale industries in the metal-based and textile groups might prosper in the long-run by entering into collaborations or working relationships with suitable large-scale units."²⁰

These surveys suggest the necessity for more comprehensive surveys in order to ascertain the differential advantages of different categories of industries in different areas before they can be taken up for development in different regions.

Growth Centres: Area Development Programmes

The agro-development should be integrated with the area development programmes of the region. (This would be helpful for a comprehensive development of the rural areas.²¹ This development approach would arouse consciousness of regional independence, self-reliance, and technological advancements which would also generate sufficient non-economic motivations for the regional development programmes.) This would however require careful selection of the areas and appropriate policy decisions.

Different criteria for the Growth Centres, as these are called,

¹⁹S. D. Thapar, *Need for Modernization in the Small Sector*, Mimeographed, Small Industries Service Institute, New Delhi.

²⁰*Ibid.*, p. 6.

²¹*Report of the International Perspective Planning Team*, pp. 123-32.

are being considered by the Government of India.²² The importance of such centres has been recognized even by the United Kingdom which has been trying to identify and develop "Growth Points" in its own country. The Draft Outline of the Fourth Five Year Plan envisaged development of about 700 such centres all over the country, approximately two such centres were expected in every district. Several States have already initiated action with regard to the identification of such Growth Centres: more than 286 Growth Centres have already been selected in different States. But this is just a beginning of the stupendous task. The programmes of development of these areas would involve much careful planning. Decisions with regard to the various industries that should be incorporated there will have to be thought of seriously. But in order to make this programme a success and to safeguard it from falling in the same groove as the earlier ones, it is necessary that much careful planning of economic and non-economic factors is done from the very start.

By coordinating the programme of Growth Centres with agro-industrial development, it is possible that this programme would be able to develop and arouse proper motivations for self-reliance as opposed to dependence consciousness on external bounties and governmental assistance. In order to achieve this objective, it is necessary that the items for production in those regions are properly selected and the levels of technology chosen in accordance with the resources available there.

²²The question of identifying Growth Centres was discussed at the 11th Meeting of the Small Industries in Community Development Blocks held in the Ministry of Industry in July 1966. At this meeting the following criteria were considered: population range (15,000-50,000), rate of growth (faster than other areas in the State); proximity to an established industrial centre (20-30 miles away); functional orientation towards industry/commerce; mandi towns; convenient locational advantages; and intensity of agricultural advantages. Some further details can be seen from *Report of the Sub-Group on Small Scale Industries on Fourth Five Year Plan*, Ministry of Industry and Supply, New Delhi, July 1964, Chapters IV and VI.

Conclusion

(The need for rural industrialization is undeniable. The level of rural savings is undoubtedly very low ; if the extent of gap which is presently being covered either by rural indebtedness or by receipts from outside areas is taken into account, the *Retardation Quotient* of rural areas would be high.) This cannot be overcome only by increasing the levels of income and employment. This is the crux of the problem.

Agro-based industries are admirably suited for rural programmes of economic transformation. The very nature of these industries is such that they touch the village economy at many sensitive points. (The scale of operation and the structural organization of agro-industries are such that the villagers would be intimately involved in their development. It cannot be an establishment imposed on the rural economy with outside assistance. Unless the participation consciousness of the people is sufficiently activated and the decisions with regard to the setting up of these industries come from the people themselves, the agro-based industries would lose the very essence of their advantages. The great success achieved by Shri K.L. Nanjappa, Development Commissioner, Small Scale Industries, in organizing Intensive Campaigns²³ which visibly make an impact on the rural economy is primarily due to the spirit of cooperation in formulating and implementing the industrial programmes of the region. The beginning of participation consciousness will also have some influence on the superiority feeling of the people. The scale of operation and capital requirements being within the reach of the people, they would be willing to sacrifice considerable portion of their income for the investment requirements of these industries. This will foster independence consciousness; people of the district where the agro-industries are set up would not

²³Besides the annual reports of the CSIO, see *Intensive Development Campaign*, Small-Scale Industries in India, Souvenir Volume, Development Commissioner, Small-Scale Industries, New Delhi, 1968, pp. 190-200.

n every case look for governmental assistance for the purpose. This will have a revolutionary impact.

As a result of such psychological changes in the locality, there will be better climate for labour-employer relationships which will markedly improve the income-coefficient of the capital stock. When economic development begins on sound lines, the society would also be "open" to new entrants to the labour market from outside regions; it will also be more considerate to the outside technicians and will more readily absorb them in the community. Cultural factors are intimately connected with the level of technology available in any region, but this way of development where those techniques of production which are easily comprehended by the local inhabitants and for which the capital requirements are within their reach, are introduced; the people would be "open" to the change and in this way, it would also be a process of cultural fusion, badly needed for a country like India. All these changes would take place simultaneously with the increasing levels of income.

By developing agro-based industries it would be easier for underdeveloped regions of India to move from Stage I of development to subsequent stages of growth. If the "enclaves" of industrially developed areas have to merge with the developing regions of the country, it is important that the agro-based industries are given appropriate place in the programmes of rural development which these industries rightly deserve.

CHAPTER VIII

INFLATIONARY RECESSION

EVER since independence, India has been passing every fifth year through acute economic strain. Five years after independence, in 1952-53, severe unemployment plagued the country necessitating an upward revision of the First Plan outlay. Five years later, in 1957-58, there occurred the foreign exchange crisis. This led to the division of the Second Five Year Plan in Part A and Part B—the former considered as the “core” of the Plan for implementation purposes, and the latter to be taken up only if additional resources became available. Again, after five years, in 1962-63, the Indian economy was seriously disrupted. This time, it happened due to the Chinese aggression. The cycle was repeated once more in 1967-68 when the Indian economy was paralysed by the disturbance which the *Economy Survey, 1967-68*, categorized as “Recession.”

Lest such disturbing cycles repeat, it is necessary that the causes of such fluctuations are investigated in depth and remedial measures initiated. During the course of economic growth, it is natural to expect that prices, demand, and production would change significantly, but periodicity in these fluctuations causes anxiety. Such fluctuations have several undesirable sociological, political, and economic repercussions. These fluctuations, directly or indirectly, affect every individual. Periodicity of such fluctuations has often been categorized as trade cycles of which the economists talk in a very specialized language. But, this is a phenomenon with which every individual ought to be familiar so that he could understand and appreciate the complicated nature of the problem.

Periodicity : A Danger Signal

The phenomenon of recurrent cycles has been widely pre-

valent. Once this subject was considered so much important that the economists were looking for every type of explanation for it. Periodicity of these cycles had been so distinct that the periodic reappearance of the sun-spots with consequential atmospheric changes leading to fluctuations in agriculture and manufacturing activities was considered as its main explanation. In fact, this situation has been so intriguing that the economists, during the last two hundred years or so, have suggested a large number of theories on this subject.

Empirical investigations in different countries over a large number of years have confirmed the occurrence of three main types of such cycles. These cycles are said to stretch over a hundred-year period, over a twentyfive-year period, and over a seven-year period. The last category has been the most disturbing one. It upsets all estimates of economic development. It causes considerable instability in the economy. It is all the more disturbing if such cyclical fluctuations occur despite planning efforts. The nature of these cycles must, therefore, be investigated thoroughly. Explanation for their origin, amplitude, reversal and repetition must be found out. The five-yearly cycles of economic fluctuations experienced in India so far, may not be really examples of trade cycles but this conclusion should be arrived at only after careful investigation.

The necessity for such an examination has been great because the intensity of these cycles has been increasing. Unless the nature and causes of these cyclical fluctuations are appropriately investigated and satisfactorily explained it is likely that these economic fluctuations might take away most of the advantages of planning efforts.

Many explanations of trade cycles have already been suggested. Some of them have been discussed purely in monetary terms, others have been done in terms of psychological behaviour of the entrepreneur, growth functions, periodic exhaustion of investment opportunities, discontinuity in the origin of innovative activities and in terms of the acceleration principle.

The very fact that there are so many theories about trade cycles suggests that much more work has yet to be done.

Theories of Trade Cycle

Since the publication of *The General Theory of Employment, Interest and Money* by J.M. Keynes, the trade cycle theories seem to show a tendency of convergence. The current approach has been to study the phenomenon under defined parameters—Model Analysis which is expected to lead to greater clarity in thinking and to logical nature of conclusions. These discussions have been in terms of Keynesian concept of an equilibrium level of output and employment. The explanations are often given in terms of the double inter-relationship between investment and income. Frisch, Harrod, Samuelson, and Hicks have explained the phenomenon in terms of the accelerator principle which regards investment as a function of the *rate of change* of income rather than of the income itself; while Kalecki and Kaldor consider investment to be an increasing function of the level of output and a decreasing function of the stock of capital. Explanations of the industrial fluctuation differ primarily in three points, namely, (i) the problem of linear behavior, (ii) the representation of the investment function, and (iii) the problem of the trend.

If investment is assumed to be an independent variable and marginal propensity to consume less than unity, any deviation from the Keynesian equilibrium would be restored automatically in due course of time. Complications arise when changes in investment as well as in consumption resulting from any changes in income are examined. Depending on different values of the accelerator coefficient and the marginal propensity to consume, the equilibrium achieved in the economy may be either totally instable or only partially stable. If one operates with linear coefficients with constant marginal propensity to consume and constant accelerator, there would appear "damped" or "explosive situations" as alternatives to inherently stable situations. But, on the other hand, if the value of coefficients

itself is assumed to vary with variations in the level of output, new possibilities emerge. Under this condition, it has been argued that the system might within certain range of output be instable, whereas outside the range it might behave in a stable manner. But, there are many other reasons for assuming non-linear behaviour of investment coefficients.

Professor J.R. Hicks in his *A Contribution to the Theory of the Trade Cycle* presents a non-linear model. He shows that the fluctuations in the output generated by the combined action of the multiplier and the accelerator are confined within two constraints: an upper limit is determined by full employment, and the lower limit by the fact of the irreducible minimum below which they cannot drop. Given these constraints, it has been suggested that the inherently explosive cycles would be transformed into cycles of constant amplitude. These "constraints" play an important role in the explanations given by Professor Hicks.

The accelerator principle adopted by Professor Hicks has not been accepted by many others. They have called it "crude," "obsolete" and "unsuitable." In fact, the relationship between income and investment has not been very simple. The assumption that any change in stock of capital would be so related to the change in the output as the ratio between the value of capital stock to the value of output per unit period, may be valid only under certain specified conditions whose validity during the successive cyclical fluctuations may be doubtful. This contention is said to depend on the assumption that the ratio between output and capital is determined by technical factors, which does not change during short periods, whereas during the course of cyclical changes, this relationship undergoes continuous change. This relationship depends upon the profitability of investment and the absolute level of output. This theory also assumes that the investment generated by the change in output is some coefficient of the change in output, rather than of the absolute size of the change.

But, in fact, investment depends on many factors, such as, financial resources of the firm, the elasticity of expectation of the changes and so on. The firm cannot take advantage of large investment opportunities as quickly as of small ones. Moreover, long-run expectations are tied to some trend and the *ad hoc* decisions are, more or less, taken within the broad range. If the existing situations do not differ too much from the expected norm, the long-term expectations would be revised in term of the current facts. It is logical to assume that the relationship between investment decisions and changes in output is considerably influenced by the size of the output as well as by the anticipations relating to the future course of events.

The accelerator principle needs refinements. One way to do so is to assume that a change in income generates investments not for a single "period" of time, but for a whole series of "periods." Therefore, the accelerator coefficient instead of having a single value v , would have a large number of partial coefficients v_1, v_2, v_3, v_p each applicable to different periods. This assumption would make the theory realistic but very sophisticated and unwieldy. This refinement might make the theory realistic, but not very conducive to yielding effective conclusions for practical applications.

With reference to the problem of trend, so that a theory of economic development which is capable of explaining both, the trend and the fluctuations as resultants of the same set of influences, is possible, Professor Hicks builds a cyclical model around Professor Harrod's concept of an equilibrium rate of growth. Professor Harrod has postulated only one equilibrium rate of growth, whereas Professor Hicks is of the opinion that under certain conditions of equilibrium, the rate of growth of output as a whole will always be equal to the rate of growth of autonomous investment, whatever is the rate of growth of the latter. According to Professor Hicks, the trend of the economy will be determined

simply by the rate of growth of autonomous investment.

Analysis of the nature and implications of autonomous investments adds further difficulties to Professor Hicks' framework of the analysis of the trade cycles. Professor Harrod's problem is based on two assumptions, namely, that the savings are a given proportion of the income, and that the equilibrium ratio of investment to output is tied to the technique of production and is therefore a given function of the rate of growth. These two assumptions are so vital that with the dropping out of any one of them, as Professor Kaldor thinks, the problem itself disappears. In Professor Hicks' model, the second assumption of Professor Harrod has been eliminated which very much complicates the behaviour of autonomous investments. As a result of these complications, Professor Hicks' proposition is said to imply:

Given a certain potential rate of growth (the rate which could be attained if investment was maintained at levels appropriate to full employment and which is the compound effect of the rate of technical progress, partly dependent on investment and partly on the growth of population), the government authority could, in principle, ensure that the economy expands at that rate by expanding non-productive investment (in the form of a growing budgetary deficits or a shrinking budgetary surplus) at the same rate.

In spite of the recent contribution of Professor Hicks and others, the analysis of cyclical fluctuations is not yet complete. The present position, for practical purposes, is very uncertain. Much theoretical refinements remain to be done.¹

The Indian Industrial Recession

The theory of trade cycles has not yet been conclusively established. Therefore, the policy decisions with a view to overcoming the recurring economic difficulties cannot be

¹N. Kaldor, "Mr. Hicks on the Trade Cycle," *Economic Journal*, London, December 1951.

confidently undertaken. If this is so in the developed Western countries, the difficulties of the Indian economy can be well imagined. The Indian economic situation, in fact, in many ways is radically different from that of the Western world. It is true that India is nationally, politically, historically, and spiritually one entity, yet economically, the secluded villages in isolated regions, non-monetized sectors of the economy, lack of investment potential, absence of enlightened entrepreneurs, imperfections of the market, the degree of product differentiation, disparities in the productivity of labour, and many other characteristics of the production organization present conditions radically different from the Western industrialized world. Under such conditions, it is desirable that a new approach to the complex recurring economic difficulties of the country is attempted. A new theory of trade cycles may have to be evolved in the Indian circumstances.

The planning process in India aims at providing better living conditions to the people. It has been justified on the ground that it has tremendous potential for regulating the course of economic development and accelerating its tempo without producing the difficulties which are usually present in a free economy. One of these difficulties has been the frequent occurrence of economic fluctuations. The strategy of planning is said to succeed in securing industrial transformation without involving the risk of serious industrial setbacks. Planning is not a road to serfdom only when it provides to the individual better opportunities of life than it is possible for him otherwise.

During the period of planned economic development, the community has to accept severe hardships in many ways. No individual can be permitted to set up any economic enterprise which is likely to be harmful to the community. Particularly, in the Indian situation the establishment of every new enterprise, whether in large-scale or in small-scale sector, is regulated by various governmental regulations. The distribution of scarce raw materials, permission for importing industrial raw materials,

components and parts as well as sanction for substantial expansion of industrial capacity and imports of capital goods are all controlled and regulated by the government. Retail distribution of consumer goods is expected to be free but even in this sphere, many regulatory restrictions have been imposed. As far as food articles are concerned, there are different kinds of food prices, procurement levies, and a kind of statutory rationing in a large number of cities is already operating. Otherwise also, the government has been trying to influence the market prices of different consumer articles.

Here, we are not analyzing the social and economic consequences of these restrictions, but we merely wish to refer to the widely pervasive nature of government controls and regulations. Under these conditions, the course of economic development should not be worse off than under *laissez faire*. Economic fluctuations occur frequently in a free economy. This tendency, however, is expected to be controlled under planning. But, Indian experience has shown that the planning has failed to grapple with such a situation. Serious catastrophes have occurred every fifth year. These cyclical fluctuations have been very different from the trade cycles in a developed country. It may, therefore, be useful to study in detail the nature of such cycles.

In fact, such a study would be complementary to the planning process. In an underdeveloped country, planning is attempted to provide a secure basis for rapid economic expansion. It is never the objective of any planning machinery, excepting in a centrally directed economy, to concentrate economic initiative in the State sector. The task of providing food, clothing and shelter to the teeming millions is indeed colossal. Any government in a free economy hoping to fulfil this responsibility without any assistance from the private sector is bound to get into difficulties.

Freedom of individual enterprise can succeed only in an atmosphere of assured future. But, this stability is seriously endangered when there are economic fluctuations. Frequent occur-

rences of industrial fluctuations might damage the optimism of a growing society. It might disrupt the schedule of preferences of the people. It might induce uncertainties among the businessmen. The market might become instable and the economy would get disrupted. The planning process is expected to provide stability to the economy, as well as hope and optimism to the people, but when the economic organization has been disrupted and the economic machinery has gone out of gear, it would be futile to expect prosperity of the people. Therefore, in the interest of effective planning of the country, it is necessary to go deep into any unusual experience and derive lessons from it.

Frequent occurrences of five-yearly economic fluctuations have suggested that there is some deep-rooted malady in the economy which must be discovered, examined and remedied. The five-yearly cycles are different from the seven-yearly trade cycles. Causes which induce industrial fluctuations in an advanced country may not be operative in an underdeveloped country, at least not in the same intensity. It has often been suggested that the five-yearly cycles of economic fluctuations, as indicated above, may have some direct or indirect relationship with the planning period. The usual linkages of the tempo of development with government regulations and economic decisions as a consequence of quinquennial plan formulations may have something to do with these five-yearly cycles. This contention has to be investigated in depth before any final answer is given and any scientific hypothesis suggested. This will also indicate the manner in which planning machinery should be recognized.

But before any exhaustive treatment of such a complicated phenomenon is attempted, it may be instructive to examine the nature and extent of the latest industrial fluctuation. We do not, however, wish to establish here that the tempo of investment activities, natural calamities as reflected through fluctuations in agricultural yield and political manoeuvrings of unfriendly countries are intimately connected with the

formulation of five-yearly plans of economic development. We do not wish to support Malthusian doctrine directly or indirectly either. These are, however, intriguing questions which interested persons may pursue separately.

Main Features of the Indian Recession

Economic Survey, 1967-68, has described recession in the following words:

Recent industrial experience is often described as a recession. This description does not, however, mean a general decline in industrial production or in economic activity. The volume of industrial production has, in fact, continued to rise. However, there has been a notable slowing down in the growth rate, or absolute decline in certain industries. A number of other industries have maintained or improved their rates of growth.²

The economic deterioration in 1967-68 as described above becomes very pronounced if compared with the state of the economy in the preceding year. *Annual Plan Progress Report 1966-67* issued by the Planning Commission has stated as follows:

1966-67 was another difficult year for the Indian economy. The monsoon failed for the second year in succession and a large part of the country suffered from want of timely and adequate rainfall. As a result, agricultural production stagnated around the previous year's level which was itself 16 per cent lower than in 1964-65. Shortage of foodgrains and agricultural raw materials persisted and large imports had to be made to maintain availability even at a very much reduced level. Growth of industrial production further slackened and national income in real terms registered only a marginal increase. Exports fell and the strain on the balance of payments remained unabated. Credit policy continued to be restrictive, yet money supply increased faster than real output. Prices rose sharply and wage pressures developed. Resources for development shrank, investment climate deter-

²*Economic Survey*, Ministry of Finance, New Delhi, p.10.

iorated and investment decisions were deferred. Both the rate of domestic savings and the rate of investment declined.³

This shows that the economic condition in India has been deteriorating for some years. This implies that there have been certain forces at work which reached their climax in 1967-68. Talking about the main features of the recent industrial recession, ex-President of Federation of Indian Chambers of Commerce and Industry, L.M. Birla, stated that the crux of the business uncertainty has been "not over investment but fall in demand." On a detailed examination of the various data available on the subject, one finds the five main characteristics of the phenomenon: (i) simultaneous occurrence of inflation and recession; (ii) not the quantum but the rate of growth has been sluggish; (iii) engineering industries excluding electrical ones have been worst affected; (iv) even within the same group of the industry, many enterprises which have been maintaining quality products have been progressing and expanding despite general recession; and (v) West Bengal, Maharashtra, and the Punjab have been more affected by industrial fluctuation than other regions of the country.

Simultaneous Occurrence of Inflation and Recession

The index of wholesale prices to the base 1952-53 equal to 100 increased from 152.7 in 1964-65 to 165.1 in 1965-66 and 191.3 in 1966-67. During the last week of December 1965, it was 169.1 which increased to 196.2 a year later and to 207.4 during the last week of December 1967. Even the price index of finished manufactures increased from 135 in 1964-65 to 145 in 1965-66 and 156 in 1966-67. As against such increases in price index, the decline in the rate of industrial production became much pronounced during the first three years of 1960's. The industrial output increased by more than 8 per cent annually. Since then, the growth rate has diminished; in 1965, production rose by only 5.6 per cent; in 1966, by only 2.6 per cent and in the first three quarters of 1967, the in-

³*Annual Plan Progress Report, 1966-67, Planning Commission, New Delhi, p.1.*

crease did not exceed 1.4 per cent. From this, it can be clearly seen that the possibility of any decline in the price line cannot be the prime mover of the recessionary trend. It is also not true that there has been any apprehension of any decline in prices leading to a decline in the marginal efficiency of capital or further decline in the anticipated profit which might make it necessary for the industrialists to reduce the scale of their operation. The main impetus for the downward turn in industrial production must therefore be something else.

Three possible causes have been suggested for the industrial setback. They are: (a) shrinkage in demand despite high level of prices maintained artificially; (b) non-availability of adequate level of industrial raw materials due to controls as a result of which the industrialists have failed to expand the scale of their operations thus causing much unutilized capacity in various industries; and (c) transitional phase of technical obsolescence occurring simultaneously in a large number of industries which necessitated replacements leading to temporary postponement of production decisions in order to incorporate technological innovations and to carry out the modernization programme. These explain, to a great extent, the possibility of simultaneous occurrence of inflation and recession.

Not the Quantum, but the Rate of Growth has been Sluggish

The recent recession does not necessarily suggest that there has been general decline in industrial production. On the contrary, in certain sectors, the production trend has been upward, though in some industries stocks have been piling. A noteworthy feature of the phenomenon has been the slowing down of the annual *rate* of increase. In a study carried out by *Economic Times* it was shown that the sale proceeds of almost all industries excepting those of the engineering group have been increasing. But, this has not been accompanied by any accelerated rate of production programme during the last few years. In order to assess the general health of the

economy, the absolute level of production is not so much important as the rate of change in the schedule of production. The Indian economy has been currently bogged up in such a malaise.

Uneven Impact of Recession

The recent industrial recession did not affect all the industries alike. Despite the pessimism aroused as a result of the recessionary atmosphere, there have been many industries which have even been carrying out their expansionary programmes. Among those industries which have suffered, mention may be made of food processing, textiles, and engineering goods industries. Petroleum products, and electrical machinery industries have secured impressive growth records during these years. The consumer goods industries have also been buoyant, and Directors of such industries have been exhibiting confidence in future. Cement, tyres, and chemical industries have also been practically unaffected. Some studies have indicated that the engineering industries of several categories have not been seriously affected.

Another feature of this recession has been that the efficient firms even in those sectors which have been badly hit by the recession, have maintained high morale and have been doing well. For example, the cotton textile industry experienced decline in the quantum of its production but most of the units did not face any addition to their inventory accumulation. Mafatlal Fine and Simplex had some rise in the stock of finished products, but the Directors of the former did not even report working under any pressure whereas those of the latter reported new record of sales since the inception of the company. Of the six companies studied by *Economic Times*, namely, Calico, Mafatlal Fine, Simplex, Coorla, Raghubansi and Aryodaya Spinning Mills, not a single firm recorded any decline in their sales during 1966-67. Packing industry has been badly affected, but among this group also there have been several units which have been doing well. Metal Box increased its sales by Rs 2.5 crores over the sales during the previous

year. Paper mills did not even bother about reporting on recession while reviewing their sales. As a matter of fact, several companies included under this category have been expanding their business activities and have been increasing their sales.

As far as chemical industry is concerned, several studies have shown that this group of industries has been increasing sales indicating no significant effect of the recession. Annual production of almost all categories of chemical and allied industries has increased. An examination of the situation in several units has confirmed the same trend. Amar Dye Chemicals reported that the demand for its products has been satisfactory. Polychem experienced an all time peak in 1966-67. In a few sections, there has been some adverse impact of recession. The dyestuff industry which mainly depended for its growth and expansion on the textile industry, and the paints industry which derived its basic materials from chemical industry, have, however, been affected to some extent by the general recession. Within the general group of chemical and allied industry, all units have not fared alike. For example, Alembic did not maintain the usual high pitch of production, whereas Dharangadra experienced slight fall in sales and increase in stocks. Talco, on the other hand, showed decline in its inventory accumulation.

The current situation in the automotive tyre manufacturing concerns has also been heartening. Goodyear India, Dunlop Rubber, and CEAT tyres have all expressed satisfaction on their production programmes. Following the liberalization of imports, many of the enterprises included in this category have been working to full capacity.

Available evidence showed that the engineering industry was the worst affected sector. But, even in this category of enterprises, all the firms have not been identically influenced. There have been mainly five categories of manufacturing units which are included in this group, which are. (i) basic metal industries; (ii) metal products excepting machinery and transport equipment; (iii) non-electrical machinery; (iv)

electrical machinery, apparatus and appliances; and (v) transport machinery. Excepting electrical machinery, all other industries included under this group have shown recessionary impact. But, even among these, those manufacturing units which have been connected with transport machinery and those which have been functioning as ancillaries to bigger units have suffered most. This, however, does not imply that the recessionary impact has resulted in the decline of their production. The main symptoms of recession in this group of industries have been increasingly larger degree of underutilization of installed capacity and increases in accumulation of inventories. Underutilization of installed capacity in the case of agricultural machinery, boilers, railway wagons, heavy structurals, and steel forgings and castings has been significant.

From the above it may be seen that the impact of recession has been very bad on the engineering group of industries, whereas chemicals have maintained the upward trend. But, whatever the group we may consider, no generalization can be made because there have been units doing well in every category of industries.

Uneven Geographical Impact

Geographically, the impact of recession has been more concentrated in West Bengal, Maharashtra, and the Punjab. Over 23,000 workers in 95 establishments were reported to have been laid off in West Bengal between 1 January and 15 March during 1967. An additional 1,000 workers were retrenched in 49 establishments. Another 700 became unemployed as a result of 8 concerns closing down during this period. In Bombay, nearly 3,000 workers were reported to have been laid off during the first half of 1967. Production in many of the enterprises in Maharashtra was so slow that several of them began considering closing down. The machine tool industry in the Punjab has been worst hit, but even otherwise as many as 4,000 engineering units were facing closing down. This has been particularly so because the Punjab is full of

small units. In this way, in those areas where concentration of units has been heavy as in the case of the Punjab, Maharashtra, and West Bengal, the intensity of recession has been severe.

Identification of Causes

Economic Survey, 1967-68, issued by the Ministry of Finance has discussed the problem of recession in great detail. It has mentioned that the present setback in the economic situation should be attributed merely in terms of decline in the general level of demand. The adverse effects complicating the supply position should also be considered in this context. The *Economic Survey* has distinguished three levels of causes, namely, the direct consequences induced by bad harvests and difficult foreign exchange situation, the secondary influence of diminishing purchasing power in depressing the demand of transport services, and thirdly, the general slowing down in the process of capital formation.

Economic Survey, 1967-68, has emphasized the significance of supply restrictions as expressed in reduced availability of imported inputs and indigenous raw materials. At present, a large number of industries depend upon agricultural production for the supply of their basic raw materials. Significance of this point can be gauged from the fact that several major industries in India still depend upon cotton, jute, and food processing articles which are agricultural outputs. The production of agricultural output was badly damaged in 1965-66 as well as in 1966-67. This considerably reduced the availability of such industrial inputs. But failure of agricultural crops was also accompanied by foreign exchange scarcity which led to reduced quota of imported items. These two taken together reduced the supply of industrial raw materials to a great extent.

Many engineering and chemical industries depend on imported raw materials, components, and spare parts. When foreign exchange difficulties were accentuated in 1965-66 and imports were curtailed, the supply of inputs for these industries was

seriously reduced. During 1966-67 as well, such import restrictions continued. It was only after devaluation of the Indian rupee in June 1966, that the policy was reversed, but such policy changes do take time in creating the effect. Liberal import policy adopted in 1966 could therefore replenish the industrial requirements only after a time-lag.

But, by the time the toning influence of import liberalization could be realized, the agricultural harvests failed, thereby reducing the purchasing power with the large bulk of the people. This, in its turn, reduced the demand for industrial products. Advantages of increasing industrial production which could accrue as a result of liberal import policy could not therefore be realized. Thus, we find that the foreign exchange difficulties together with bad harvest have been the *direct* causes of the recession.

The secondary influence of these industrial restrictions was perceived in reduced demand for transport services. The demand for transport services decreased during this period. It had a dampening effect on transport oriented industries such as railway wagons, trucks, tyres, and tubes. The output of this group of industries declined by nearly 6 per cent in 1966. In 1964-65, the production of railway wagons had reached a peak level of 23,800 units. After that year, the curve moved downward. Total production in 1966-67 was only 15,000 units, and during the first half of 1967-68 the rate of annual production of this item was not more than 11,000 units. Similarly, the output of commercial road vehicles fell from a peak level of 36,900 units in 1964-65 to 35,600 units during 1966-67 and during the first half of 1967-68, the rate of annual production of this item was not more than 25,600 units. Thus we find that the transport oriented industries were bound to be seriously hit.

Decline in the production of transport equipment was accompanied by an overall slowing down in the process of capital formation. This happened both in the public and the private

sectors. In the public sector, the investment outlay which accounted for about 60 per cent of the total national investment, did not sustain the momentum built up during the Second Five Year Plan and the early years of the Third Five Year Plan. While gross capital formation at current prices financed out of the budgetary resources of the Central Government increased by more than 20 per cent during 1962-63 and by nearly 30 per cent in 1963-64, the corresponding proportions in the later years were only 10 per cent, 7 per cent, and 4 per cent. Budget estimates for 1967-68 also showed a further decline. This restraint on the part of the government was caused by budgetary disequilibrium experienced during the period. Purchases of capital goods by the Director General of Supplies and Disposals declined by more than 8 per cent during 1966-67.

In the private sector too, there has been decline in its investment outlay. This decline was caused by several factors such as rise in the rupee cost of imported components, uncertainty regarding future demand for the products, decline in profit expectations, etc. Devaluation of the Indian rupee also reduced the profit margin in several industries. Decontrol in the allotment of scarce raw materials by introducing to a limited extent competition among the units eliminated many of the inefficient units. Though the investment expenditures in many of enterprises declined, yet in several of them substantial production capacity was already achieved due to the momentum given by the earlier investment programmes. The widening gap between actual and installed capacities has been a significant feature of the recession.

The Federation of Indian Chambers of Commerce and Industry has also discussed some of the causes of the recent recession and has emphasized the following five factors as the main causes for this phenomenon:

- (i) *Transfer of purchasing power from urban to rural sector.* The steep rise in agricultural prices led to a transfer of purchasing power to the rural areas whose expenditure on

manufactured articles has been very limited.

(ii) *Reduction in the productive expenditure of the public and the private sectors.* For example, the Railway Board cut down its programme of wagon building in 1966-67 by 33 per cent from the preceding year's level. The cut was maintained even during the following year. This adversely affected the various sections of the engineering industries. The main units affected have been those engaged in manufacturing wagons, bridge girders, track machines, surgical equipment, and iron and steel castings and forgings. A number of ancillaries were also seriously affected.

(iii) *Decline in Indian exports* which did not pick up despite devaluation, and the various export promotion measures which even adversely affected the export factories. Large amount of non-project aid following devaluation has also been harmful because it enabled the industrialists to import certain items which otherwise could have been manufactured indigenously.

(iv) *Fiscal and monetary policy of the Government of India has not been helpful.* It has been argued that the increase in taxation of commodity by way of excise duties and customs duties increased the tax element and therefore the prices too increased; furthermore, the increases in corporate taxation did not leave any room for combating recession by price reduction. This happened when the monetary policy of the Reserve Bank of India was also restrictive. The rise in interest rates, the increases in the liquidity ratio of banks, compulsory investment of deposits in treasury bills, and restrictions on the distribution of bank advances between trade and industry or advances against shares and commodities affected sales and interrupted the flow of production.

(v) *The cost of production has been increasing at a time when the demand for the output has been declining.* During the course of previous five-year period, prices of industrial raw materials had alone increased by 75 per cent, while

wages were also increasing during the period sharply.

On an examination of the causes as indicated by the *Economic Survey* and the Federation of the Indian Chambers of Commerce and Industry, it would be seen that the main weaknesses of the economy have originated from the neglect of the forces arising due to slackening of demand. In fact, the weaknesses in demand can be viewed in real terms as well as in money terms.

Foreign exchange difficulties put restrictions on Indian demand for imported industrial inputs, and failure of agricultural crops led to decline in domestic demand for industrial and other products. External demand for Indian products which declined recently also added to the difficulty. This situation also reduced the public outlays, and the demand for transport oriented services weakened.

Some of the inefficient units could not withstand the impact of competition which was slightly let loose during the post-devaluation period. Monetary and fiscal policy of the government and the drift of money income to that section of population which either does not spend on indigenously manufactured (durable) consumer items, or which prefers to spend it on smuggled goods and in black markets, further accentuated the problem. The last two causes indicated by FICCI, namely, the impact of fiscal and monetary policy of the government and the increasing cost of Indian production deserve much more attention and emphasis than so far laid. Moreover, unless the crippling effects of income transfers are also taken into account, and the direction of economic development aims at encouraging production and consumption of durable consumer articles, there is always a danger that substantial investment in capital formation would lead to underutilization of installed capacity and consequently, even employment would be restricted.

Causes of Sectoral Recession

In order to investigate into the causes of sectoral recession

to which reference has already been made earlier, it would be necessary to examine the different industries more closely. In the manufacture of engineering goods, there has been heavy concentration as a result of the programmes undertaken during the last twenty years and more. Consequently, spectacular growth in its size and sophistication has taken place. Even during the various plan periods, in spite of its disapproval by many eminent economists, heavy and steel industries have been fostered in the country.

As a result of the various projects of this kind, it has been possible to lay considerable emphasis on engineering goods manufacturing industries. The increase in the production of engineering goods during the Second Plan period amounted to 93.3 per cent as against 41.0 per cent for all industries whereas during the First Plan period the increases in the production of engineering goods amounted to only 49.3 per cent as against 36.1 per cent increase for all industries. Generally speaking, the rate or growth of the engineering goods manufacture has been higher than that of "All Industries." Furthermore, the progress during the quinquennium 1959-64 has been spectacular. In fact, the index of production of engineering goods which was 109.9 in 1958 (1956=100) increased to 259.93 in 1963. Excepting for the difficult period of 1957-58, the rate of production of engineering goods has been all along high, but during the last few years, particularly after 1964, the tempo of development has substantially decelerated.

Many causes have led to the decline in the rate of increase in the production of engineering goods. Two considerations, namely, the investment policy of the public sector and the nature of the engineering goods are important in the present context. Investment requirements of engineering goods manufacturing industries have been very high. Technology has been less familiar and risk involved considerable. Consequently, during the last twenty years or so, the Indian industrialists have been reluctant to come forward in

this line of industry. Therefore, the public sector has to invest heavy sum of money in this sector. But during recent years, investment in this sector from the private sector has also been encouraged. Incentives for import substitution occasioned by difficult foreign exchange situation attracted greater attention to this group of industries. Even the growing needs of a developing economy require that the engineering goods manufacture is adequately encouraged. Furthermore, the general programme of industrialization has widened the scope of private investment in many profitable channels which has incidently led them to investing even in this sector. The encouragement to small-scale industries accorded during the recent years has also led to substantial expansion in the engineering group.

But, it should be noted that the demand for engineering goods is very elastic to income changes. Demand for these items can be postponed in case of any difficulty. In many cases, as in the case of railway wagons, as well as in the case of ancillaries, there have been, in recent years, very few buyers. Industrial inputs required for producing engineering goods are obtained either from imported sources, or from other manufacturing enterprises. Agro-based industries acquire their raw materials from agricultural production available domestically. During recent years, there has been considerable uncertainty with regard to these items. As a result of greater degree of mutual interdependence among these industries it is natural to expect that any disturbance in any section of this industry would have sympathetic disturbances elsewhere. The impulse given to one sector of the economy is likely to affect a large number of manufacturing concerns.

Engineering industries are localized in a few regions. Furthermore, this group accounts for a major proportion of the manufacturing undertakings of the country. For example, out of 62,000 working factories registered in mid-1965 about 14,000 or, roughly, one in every five have been engineering units. As

far as factory workers are concerned, one in every three factory workers has been engaged in engineering industries. Moreover, geographical concentration of engineering industries enables them to contribute substantially to the total production of different enterprises located at those places. As a result of this concentration, any setback in this sector of the industries is likely to be felt much more severely.

Another feature of this industry has been large amount of capacity built in there: it has been easier for such enterprises to have about 10 per cent per annum growth in industrial capacity whereas the rate of growth of output has been increasing only at the rate of 4 per cent per annum thus leading to considerable degree of underutilization. Gestation period in the engineering goods industries has also been very long. Therefore, capacity has been built at a time when the prospect for the economy was buoyant. Since then the outlook has, however, changed but installed capacity cannot be reduced so quickly. It is not easy to alter the industrial structure so soon. When demand for the final product has declined, the industrialists have no other alternative than to accept the situation which results in excessive capacity, and thus slump becomes inevitable.

The engineering group of industries which was vigorously energized by the expansive policy by the Government of India, received a serious setback when the impulse failed to give further encouragement. During the last few years, public expenditure has been curtailed and orders for several articles postponed. It has been already mentioned that the Railway Board curtailed its orders of wagons built in 1966-67 by 33 per cent from the level of 1965-66 and this cut was maintained even in the following year. The impact of this curtailment is bound to be significant on several enterprises.

For example, Braithwaite reported that the Railways in December 1966, had ordered for 1,636 wagons in terms of 4-wheelers while the company had a backlog of 783 wagons. This, firm was placed with an order of 2,419 wagons to be supplied by March 1968. This compared unfavourably with the

actual production which was 3,538 and 3,446 wagons during 1964 and 1965 respectively. Jessop, another engineering unit, reported that the Railway Board had asked it in January 1966 to reduce its output by 23 per cent but in actual fact the cut was increased to 50 per cent as the wheel axels with their roller bearings could not be made available by the Railway Board to catch up with its production. Another concern, namely, Alcock Ashdown has also indicated that the flow of fresh orders for its structural and tower department was considerably slowed down due to delay in finalization of the Fourth Plan.

Some industrialists from Batala, which has been the main machine tool-making centre in the Punjab, even complained that several government and semi-government organizations failed to lift the stock in spite of their having placed confirmed orders for the same. This has led to substantial inventory accumulation at these units. Thus, the economy measures of the Government of India seem to have made significant impact on the engineering goods industry which had mainly depended on the assistance and encouragement accorded by the public sector.

Many enterprises connected, for example, with cotton, jute, and food processing depended for their production programme on the supply of domestically produced agricultural raw materials. The availability of such industrial inputs as raw cotton and sugarcane has declined during the last few years. Lower domestic production as in the case of raw cotton and raw jute has been compensated by imports. The quantum of such imports however has been very much restricted. Moreover, their prices have been rising. Thus, the cost of production of these industries which obtained raw materials from imported sources has risen substantially. The demand for the output of these units has reduced because the consumers have reacted adversely.

Even the small-scale industries have been adversely affected by recession. As result of the general recession in the economy,

small enterprises had to take care and give thought to their efficiency, otherwise there was every danger of their being eliminated. Many small enterprises which showed technological backwardness, managerial inefficiency or poor quality of finished products have been squeezed out. An interesting example in this regard has been the case of machine tool industry in Batala. The graded tools with certain quality markings have been caught in the recessionary trend whereas those units which have been making ungraded tools have escaped the impact. This has been so because the former group of firms having marking arrangements with certain larger enterprises which had been defaulting in lifting the stocks; even those smaller units which were having arrangements with the public sector units had to face similar difficulties. But, those units which catered to the local needs escaped the setback to a great extent.

Generally speaking, the following four categories of small-scale enterprises were affected by recession: (i) machine tool industry all over the country, (ii) industries engaged in the manufacture of durable consumer articles like bicycles and parts in competition with large-scale units having reputed brands, (iii) enterprises functioning as ancillaries to large-scale units and those depending upon government and semi-government orders either as prime contractors or sub-contractors, and (iv) small-scale industries which did not have their own marketing organizations or which did not produce quality goods and have so far been thriving in the sheltered market which has now been receding slowly.

While explaining these points it may be indicated that recession in machine tool industry has been due to the growth of general recessionary trend in the country. As far as consumer goods are concerned, the units connected with the production of these items have also had downward trend in production. For example, in the case of bicycle industry about 20 per cent of the total manufacture has been in the small-scale sector. Furthermore, this industry has been localized pri-

marily in the Punjab which claimed 665 units though in other States too there have been several units producing bicycles. Decline in the level of production of bicycles and cycle parts has been significant in the Punjab. But, even in other parts of the country where such units were located as in the case of U.P. and Mysore, several bicycle manufacturing units have closed down.

There have been two main causes for it. firstly, the competition with the large-scale manufactures has been very keen. Efficiency of the larger units has given them an edge over the smaller producers. This is specially so, when there is consumer preference in favour of larger units. In spite of slightly higher prices many consumers prefer the cycles manufactured by well known units. Therefore, with shrinking demand it would be marginal small-scale units which would go out of production. Secondly, the demand for a large number of bicycles, particularly for those produced in the small-scale sector comes from rural areas. As a result of bad harvests, during the last few years, there has been decline in the purchasing power of the agriculturists which induced the rural consumers to postpone their purchases.

Many small-scale units which have grown because of the recent State patronage to them for developing ancillaries began suffering as a result of the economy measures adopted by the government. The development of ancillaries has been good as a welfare measure with a view to dispersing gains of industrial profit. But, in this process even the disadvantages get distributed if the larger units get into difficulties. Under monopsonic conditions, when only a few large enterprises have confirmed their orders to a large number of small scale suppliers, the impact of any setback in the large-scale undertakings is bound to be critical for small-scale units. In fact, the economy drive in several government departments on whose orders, or on whose investment many of the large public sector enterprises depended cannot but initiate a chain reaction capable of vindicating the very objective for which

ancillary development in small-scale sector has been sponsored. The recent recession has, therefore, emphasized the importance of efficiency in production. But, it should also highlight the need for a careful examination of the linkage between large and small-scale enterprises. Sheltered industries cannot thrive permanently unless they reorganize themselves efficiently and gain competitive strength.

Sectoral imbalance making the engineering goods manufacturing units, agro-based industries, and small-scale enterprises more vulnerable to any recessionary impact suggests the need for a careful examination of the industrialization policy of the government. Engineering industries have been fostered in India much ahead of their natural development. Agro-based industries have not been provided with appropriate level of industrial inputs either from domestic or from imported sources. This implies that the integration of agricultural development has not been well coordinated with the programme of industrial development. Setback experienced in small-scale enterprises has shown the weakness of inefficient linkages between small-scale and large-scale units.

When the public sector enterprises wish to make a significant impact on the concentration of economic power and regulation of industrial growth, it is appropriate that the relationship between the two sectors of the economy is critically analyzed taking into account both optimistic and pessimistic possibilities of future growth. This approach has been vitally neglected leaving the consumers, tax-payers as well as many small-scale industrialists into serious difficulties. The development of public sector is a solution of many social maladies, but its economic consequences have to be very carefully considered in order to safeguard the economy from serious setbacks.

Causes of Geographical Recession

The impact of recent recession was felt all over the country, but there were certain areas where its intensity has been severe. West Bengal, Maharashtra, and the Punjab were the

worst affected regions. One of the causes of the localization of this recession has been the concentration of engineering goods manufacturing units in Maharashtra and West Bengal which taken together accounted for 47.6 per cent of such industries. These two States taken together employ 50.1 per cent of the persons engaged in the engineering industries and they produce 55.5 per cent of their gross output. Naturally, therefore, the impact of the recessionary impulse experienced in the engineering goods industry would be serious in these areas. But, apart from this, there have been certain other factors as well which accentuated this trend.

For example, in West Bengal, there has been heavy industrial concentration around Calcutta-Howrah axis. This has created special conditions. Many large enterprises located there have encouraged small enterprises operating there as feeders to them. Consequent upon the curtailment of public sector investment in new enterprises, the small-scale engineering industries dependent upon them have been badly affected. This has been so, especially in those enterprises which catered to the railways and other transport industries. This is one of the consequences of monopsonic conditions.

Besides, a large number of big industrialists located in this area have been upset by political instability in the State. Law and order situation in West Bengal had also deteriorated considerably. When the law and order position is upset and industrial property is insecure, it would not be possible for large industries to have substantial investment in those units. As an example of this kind of difficulty it may be indicated that the Directors of Burn & Co. in their Report for 1966-67 mentioned that "for the last five months of this year under review, the workmen at the Howrah Works had intensified the go-slow tactics adopted by them from the very beginning of the year to such an extent that the production achieved has been only one-fifth of the normal output for the year." This is merely an example of the consequences of political instability on industrial production and economic development.

In fact, the Naxalbari incident created severe economic difficulties throughout the State, and it may be useful to assess the economic consequences of such political uprisings. To say the least, the atmosphere throughout the State has not, in fact, been conducive to industrial development.

In Maharashtra, there has been concentration of industries around the Kolhapur industrial complex, besides on the Bombay-Poona axis. A special factor operating at the Kolhapur region has been the change in the pattern of taccavi loans. This affected the demand for diesel engines which caused distress to small industrialists engaged in such enterprises. Internal combustion engine manufacturing units have been concentrated at Kolhapur where 40 small units have been manufacturing complete engines, in addition to nearly 200 units manufacturing parts and components required by the assembling units. Changes in the State policy for granting subsidy to the cultivators for purchasing oil engines severely affected the off-take of this industry. The restrictions on demand has naturally created a deep impact on the small-scale engineering industrialists located in this area. This in its own turn had other indirect consequences on other industries concentrated in this region.

Industrial complex in the Punjab has heavy concentration of machine tool industry, agricultural implements, bicycle and its parts manufacturing, and re-rolling industries. During the boom, all these industries had flourishing business, but when recession set in, they began facing acute difficulties. The difficulty was mainly related to the decline in agricultural prosperity, the rising cost of living index and the fall in the agricultural income due to bad harvests. Consequently, the market in the rural areas of U.P., Bihar, and the Punjab considerably shrank. This accentuated the recession in the small-scale units located in these States and particularly in the Punjab.

To sum up, industrial development in this country has been primarily encouraged by the placement of government orders

to the industrial enterprises, prosperity of agricultural and rural areas, discontinuities in the markets of different products and the political stability in various parts of the country and abroad. The introduction of five-yearly plans regulated the flow of investment outlays of the public and the private sectors. The first few years of every plan have been full of enthusiasm, but slackness begins near about the third year of its implementation; expectancy and watchfulness for the shape of things to emerge under the subsequent plan induced among the industrialists a desire to postpone important business decisions from around the fourth year of the plan. If the industrial fluctuations in the country are analysed in these terms, the temporary and the annual fluctuations are likely to yield a more meaningful pattern in order to explain earlier fluctuations as well recurrence of the same every fifth year.

Steps to Overcome Recession

In order to assist sectoral revival, specially in the engineering goods industries, the public sector industries have been advised to place advance orders. The Railways and other public departments have been instructed to place firm orders with private firms for delivery during 1968-69. The Railways have already placed orders for more than 76,000 wagons against their 1968-69 rolling-stock programme although only 10,000 new wagons were required during that year. The Bokaro Steel Plant also issued tenders for 150,000 tonnes of structurals. Air India International has placed orders for various types of equipment aggregating nearly Rs 14 lakhs. Hindustan Teleprinters and Indian Telephone Industries have together placed orders worth Rs 116 lakhs. During April-November 1967, Directorate General of Supplies and Disposals have placed orders amounting to Rs 262 lakhs. These orders were expected to have immediate impact on recovery. In order to stimulate domestic demand for certain categories of machinery and equipment, the method of selective credit control has also been adopted. The Industrial Development

Bank of India has liberalized its scheme for deferred payment sales of capital equipment and even the Reserve Bank of India has granted several concessions to commercial banks for assisting industries, specially in the small-scale sector. Concessional terms have also been accorded to export credits.

Besides, the Government of India has also adopted several direct measures to ameliorate the situation. The main features of the government policy in this regard have been as follows: (i) continued restraint on aggregate effective demand via fiscal and monetary devices; (ii) advance placement of orders on private firms by the public sector; (iii) selective credit measures for reviving home demand for engineering products of high priority; (iv) relaxation of controls on industries aimed at facilitating adjustments in production in the light of market situation; and (v) renewed emphasis on export promotion as a means off-setting the slackness in domestic sales of certain articles.

Restraint on effective demand has been advocated because of the inflationary situation already existing in the economy. Any expansionary budgetary or credit policy could have serious threat to already high food and other agricultural commodity prices. Even the external payments position is very precarious. So the policy of restraining effective demand, in spite of recessionary tendency in certain sectors, has been justified. The provisions of the Industries (Development and Regulation) Act were already liberalized to some extent after the devaluation of the Indian rupee. Later on, however, in December 1967, the scope of liberalization was further expanded to cover fuller utilization of installed capacity.

The Federation of Indian Chambers of Commerce and Industry, while appreciating the various steps taken by the government, has suggested seven other measures which could be helpful in this regard. These measures are:

(i) Reduction of non-productive expenditures on items like subsidies, community development, rural works, etc., and on industrial projects with long gestation period. Expenditures

on infrastructure and quick yielding projects have to be strengthened.

(ii) Fuller utilization of heavy and medium structural fabricating industry to complete rapidly the public sector projects which are already in hand. In view of excess capacity in structural fabrication, investment in steel foundries at Hardwar, Wardha, Varanasi, Bokaro, and Rourkela to be deferred or cancelled altogether.

(iii) Fiscal incentives should be provided to stimulate demand and production which could be done by selective reduction of excise duties and in company taxation.

(iv) The credit policy of the Reserve Bank of India has to be further liberalized.

(v) Manufacturers should be given further freedom in adjusting to the pattern of demand. Recession should be considered as an opportunity for correcting some of the basic policies such as price controls, industrial licensing, etc.

(vi) Provision of special export incentives and facilities should be made.

(vii) Protection to import substitution articles should be accorded but import licensing should be replaced by a rational system of import tariffs.

These suggestions by the Federation deserve careful consideration. Undoubtedly, they are expected to create far-reaching consequences on the Indian economy. Adoption of these measures may in many ways imply radical orientation of the government policy. The efficacy of these suggestions in correcting the immediate problem may be questioned by many. But, if it is accepted that the basic approach to the programme of Indian industrialization has to be modified, in that case, the suggestions made by the Federation would deserve special consideration. The remedial measures for the revival of Indian industries could be classified in two categories, namely, short-term and long-term measures. Both these measures should be well integrated.

The impact of recession on the Indian economy, particularly

in the small-scale sector, has also been studied by a Study Team set up under the Chairmanship of Dr P. S. Lokanathan⁴. Having considered the various facets of the problem, the team has recommended several short as well as long-term measures for assisting the development of small-scale sector. The immediate need, according to the Team, has been to strengthen the stock-holding power of the industrialists. Liberal credit facilities and liberalization of Credit Guarantee Scheme have been important steps in this context. Time Bills and Usance Bills for short-term accommodation have been recommending.

The long-term measures which have been recommended by the Team relate to technical assistance, marketing, raw material allotment, and fiscal measures. The structural weaknesses of the economy, so far concealed under protective measures of the government, should be eliminated. Since the present difficulties have emphasized the need of improving the quality of output, the Team has suggested, that the present impasse should be taken as an opportunity for providing such measures as technical consultancy services of higher grades and quality markings. Such steps should be helpful in several industries like machine tools, automobile ancillaries, bicycles and parts, sewing machines, agricultural implements, internal combustion engines, electrical motors and transformers, and foundries. marketing counselling services and regular seminars have also been suggested for bringing the producers and sellers of different articles produced in small-scale sector together. Demand forecasting and farming of such bulk orders of the government and public sector undertakings as can be given to small-scale industries should be channellized to them.

The Team has also recommended that the small industrialists through their associations should even explore the possibilities of forming special consortia for undertaking large orders which individually the constituent units may not be able to supply.

⁴ *Report of the Study Team on Recession in the Small Scale Sector*, D.C.S.S.I.O., New Delhi, 1968.

Where such consortia are formed and given legal status, they might be given special consideration in the matter of farming government orders as well. The opening of trade centres and regular exhibitions displaying the details of the articles produced by the small-scale sector might be useful in promoting the sales of such industries. Many small industrialists have been eager to extend their activities in import substitution sector. In order to encourage it, the Team has suggested that the prototypes of such articles may be more freely imported and permission for dismantling and examining them with a view to evolving Indian models without infringing the patent rights given. In some cases, shortages of critical raw materials which, so far, have been imported, as for example, special types of ball bearings required for machine tools, or nickel required for plating bicycle rims, should be more adequately supplied.

Recovery and After

As a result of the various measures adopted during the last year or so, recession has been contained. *Economic Survey, 1968-69* has pointed out that the bumper harvest of 1967-68, and the consequent rise in disposable income in the agricultural sector have led to the recovery in industrial production. The economy has now been looking bright. The big questions, however, still loom large: Is the Indian economy still dependent for its growth on the monsoon? Has development planning not yet found an answer to industrial and economic fluctuations? Will there again be a major setback in 1972-73? These are the big questions to ponder over.

CHAPTER IX

UNEMPLOYMENT

UNEMPLOYMENT is a complex phenomenon. If the working population of a country is not given gainful employment, it does not only reveal economic bankruptcy, but also portends national disaster. This is so because unemployment has widespread repercussions. Sociological overtones of this situation cannot be lightly overlooked without causing lasting imbalance in the economy; the very foundation of nationhood could crack in consequence. It is necessary that an all-out attempt be made to tackle this vital problem. This is the first charge on every sovereign State. But, it has to be recognized that gainful employment is merely a means to an end. Bread is important to keep body and soul together, but mankind survives by faith, aspiration, and ideals. These objectives can be attained only after the basic requirements of human beings are satisfied. Unless this is done, the nation cannot hope to provide good life to the people. When the higher objectives of life are not fulfilled, the very purpose of living is be-clouded and frustration is intensified. The growing lawlessness among the students and the working class, and the profound disillusionment among the educated and the thinking persons have been the symptoms of a deep rooted malady in our body politic. The country is heading towards a cataclysm. Despondency among the engineers, doctors, teachers, and civil servants and indiscipline among the students are indications of the extent of damage done to the economic fabric of the country. Without a radical transformation of the economy, it would be extremely difficult to save the country from serious disaster.

The country can be saved only when the basic urges of the people are satisfied. Without the recognition of the basic forces influencing the fundamental motivations for the human

action, the programme of national economic development would fail to achieve its goal. This has been demonstrated by Dr Erhard. He created a miracle in the German economy by basing his economic programme on such basic principles of human motivations. Acting on the same principle, the French planning has regained her past strength and has become one of the strongest international powers. But, India has not, so far, been able to recognize the importance of the individual. Despite a generation of independence, India has failed to provide gainful employment to her people. A large mass of the Indian population is still without proper shelter; many people go without two square meals; and majority of the population is still without proper clothing. If the size of the country is so colossal and the structure of the society so complicated that decent living standard cannot be guaranteed to *all* its people, it is imperative that the development techniques are radically altered and plans appropriately modified to suit the native conditions. The new generation of the country born particularly after the independence cannot remain docile, contented and mute in a stagnating society. Sooner the youthful spirit is channellized into useful purposes and new horizon of creative national activities shown to them, better would it be for the economic regeneration of the country. Failing this, economic chaos with far reaching social consequences is inevitable.

India has been suffering from unemployment and underemployment for a very long time. Even at the time of independence, unemployment situation in the country was disturbing. Partition further accentuated the problem; it disrupted the economic balance of the country. Massive influx of refugee population from Pakistan as well as from other parts of the globe further intensified the problem. These events were over and above the chronic unemployment resulting from the rapid growth of population, the disappearance of old rural industries and the inadequate development of non-agricultural sector of the economy. Soon after independence, vigorous

efforts were made to overcome the problem, but the progress achieved was heartening. The Sindhis and the Punjabis with their tenacity established a large number of business concerns and small scale industrial enterprises. The enthusiasm and the zeal with which the First Five Year Plan was inaugurated in the country revealed the earnestness of the government for solving the problem. The First Five Year Plan was expected to bring about a radical transformation in the country. When the unemployment situation further deteriorated in 1952-53, the plan outlay was revised upwards with a view to including rural works and other programmes expected to ameliorate the difficulty. A large-scale programme of economic development began under the impact of the First Five Year Plan. These programmes were considered necessary for initiating a new movement of economic recovery. The First Plan diagnosed the primary cause of Indian unemployment situation to be the deficiency of aggregate demand and the shortage of capital equipment. The huge investment outlay envisaged under the First Five Year Plan was expected to mitigate these difficulties considerably.

The Theory of Employment

The First Five Year Plan of India was formulated under the influence of the Keynesian doctrine of full employment. According to this doctrine, an increase in the investment outlay by stimulating effective demand in the community could increase its employment potential. The Keynesian *General Theory of Employment, Interest, and Money* gave an economic justification for the public sector activities for energizing the sluggish demand. For removing unemployment, Professor Keynes suggested that the treasury might even fill old bottles with bank notes, bury them at suitable depths in disused coal mines and then cover them up to the surface with town rubbish, and "lease it to private enterprise on well-tried principles of *laissez-faire* to dig the notes up again." According to Lord Keynes, it is much more sensible to build houses and the like, but "if there

are political and practical difficulties in the way of this, the above would be better than nothing."¹ Professor Keynes indeed gave a new direction to employment theories, and he provided theoretical justification for his conclusions. Ever since the publication of *The General Theory*, the employment theories, in spite of several refinements and disagreements, have hinged round the Keynesian doctrine.

The volume of employment, according to Professor Keynes, is determined by the point of intersection of the aggregate supply function with the aggregate demand function. If Z be the aggregate supply price of the output from employing N men, the relationship between Z and N being written as $Z = f(N)$ may be called the *Aggregate Supply Function*. Similarly, if D be the proceeds which the entrepreneurs expect to receive from the employment of N men, the relationship between D and N being written as $D = f(N)$ would be called the *Aggregate Demand Function*. The term "demand" as used by Keynes refers to aggregate demand of the whole economic system. The aggregate demand function is a schedule of the proceeds expected from the sale of the output resulting from the varying amounts of employment. But the total income generated in the economy can be spent either on consumption items or on investment goods. This is represented by the identity

Income (Y) = Value of Output - Consumption (C) + Investment (I).
Consumption in any economy depends upon the level of income and the level of expenditure on consumption out of that level of income. The propensity to consume is a functional relationship between a given level of income and the expenditure on consumption out of that level of income, so that $C = F(Y)$. Average propensity to consume would be denoted by $[C/Y]$ and marginal propensity to consume by $[\Delta C/\Delta Y]$. Amount spent on consumption goods would depend on propensity to consume, but this propensity itself is influenced by six objective factors and eight subjective needs,

¹John Maynard Keynes, *The General Theory of Employment, Interest and Money*, Macmillan, London, 1949, p. 129.

psychological propensities and habits of the constituent members of the community.

The six objective factors are (i) changes in the wage unit, (ii) changes in the difference between income and net income, (iii) windfall changes in capital-values not allowed for in calculating net income, (iv) changes in the rate of time-discounting, i. e., the ratio of exchange between present goods and future goods, (v) changes in fiscal policy, and (vi) changes in expectation of the relation between the present and the future levels of income. The eight subjective motives which lead the individuals to refrain from spending out of their incomes may be called the motives of precaution, foresight, calculation, improvement, independence, enterprise, pride, and avarice. Propensity to consume differs with different income groups of the society. The proportion of income spent over consumption goods is greater among the lower income group than among the higher income group. When income increases, it changes the amount of consumption directly but not proportionately. The propensity to consume is lower in the higher income group and it is very high in the lower income group. As a result of this behavioural characteristics, the multiplier effect resulting from propensity to consume would be different in economies having the same levels of income but with varying distribution of the same. When there is an increment in aggregate investment, income will increase by an amount which is k times the increment in investment, if k is considered as the multiplier. The multiplier (k) is defined as reciprocal of 1 minus marginal propensity to consume, that is,

$$k = \frac{1}{1 - \Delta C / \Delta Y}$$

Now, let us consider the investment side of the picture. The amount of investment depends upon the Marginal Efficiency of Capital and the Rate of Interest. The relationship between the prospective yield of capital asset and its supply price or replacement cost, i.e. the relationship between the prospective

yield of one more unit of that type of capital and the cost of producing that unit furnishes us with the *Marginal Efficiency of Capital* of the type. If there is any increase in the investment of any type of capital asset, its prospective yield will decline and the supply price of that capital asset will fall. According to the decline in the marginal efficiency of capital with every increase in investment, a schedule is drawn which shows how much investment should increase within the period so that the marginal efficiency of capital falls to any figure. An aggregate of such schedules for all the different types of assets would provide a schedule relating the rate of aggregate investment to the corresponding marginal efficiency of capital in general. This schedule is known as the Schedule of Marginal Efficiency of Capital. The actual rate of current investment will be pushed to the point where there is no longer any class of capital assets whose marginal efficiency exceeds the current rate of interest.

The rate of interest is another factor influencing the level of investment in any community. The classical economists believed that the rate of interest depended upon the intersection of the schedule of the marginal efficiency of capital with the psychological propensity to save. But, Keynes has stated that the notion that the rate of interest is the balancing factor which brings the demand for savings in the shape of new investment forthcoming at a given rate of interest into equality with the supply of savings which results at the rate of interest from the community's psychological propensity to save, breaks down as soon as we perceive that it is impossible to deduce the rate of interest merely from a knowledge of these two factors.²

The quantity of money is the other factor, which in conjunction with liquidity preference determines the actual rate of interest in given circumstances. Liquidity preference is a functional tendency which fixes the quantity of money which the

²*Ibid.*, p. 165.

public will hold when the rate of interest is given. If r is the rate of interest, M the quantity of money, and L the function of liquidity preference, we have $M = L(r)$. This is where and how, the quantity of money, according to Professor Keynes, enters into the economic scheme.

Liquidity preference shows the tendency to hold money for different purposes such as transaction, precautionary, and speculative motives. Liquidity preference remaining the same, the level of income also influences the amount of money available in the money market.

From the above description of the Keynesian demand analysis, it would be interesting to see how the treasury notes in empty bottles could augment the aggregate level of income. This is through the multiplier which has already been referred to above. It has been stated that the marginal propensity to consume is $\Delta C / \Delta Y$ and $Y = C + I$. From these identities, it is possible to write $\Delta Y = \Delta C + \Delta I$.

Dividing both sides by ΔY , we have

$$\begin{aligned}\frac{\Delta Y}{\Delta Y} &= \frac{\Delta C}{\Delta Y} + \frac{\Delta I}{\Delta Y} \\ \text{or, } \frac{\Delta Y}{\Delta Y} - \frac{\Delta C}{\Delta Y} &= \frac{\Delta I}{\Delta Y} \\ \text{or, } \left[1 - \frac{\Delta C}{\Delta Y} \right] &= \frac{\Delta I}{\Delta Y}\end{aligned}$$

Since multiplier k is defined as $\left[\frac{1}{1 - \Delta C / \Delta Y} \right]$, substituting

the value of $\left[1 - \frac{\Delta C}{\Delta Y} \right]$ in the above equation, we have

$$\begin{aligned}\frac{1}{k} &= \frac{\Delta I}{\Delta Y} \\ \text{or, } \Delta Y &= k \cdot \Delta I,\end{aligned}$$

which tells us that when there is an increase in investment outlay, marginal increase in income in the economy would be equal to k times the increment in investment. This is why the impact of any government spending may be several times more than its

initial impulse.

Changes in effective demand by themselves do not completely explain the changes in the level of output, and thus, the level of employment. Any change in the aggregate expenditure of the community does not necessarily lead to a proportionate change in the expenditure on all the products. Whenever there is a change in personal income, the individual does not proportionately change his expenditure on every product. It is necessary to consider his reaction to different commodities arising from such conditions. This is done under the aggregate supply function which relates employment with the aggregate supply of corresponding output. The aggregate supply function can be converted into employment function. The aggregate supply function is, in effect, the inverse employment function and it is defined in terms of the wage units. The object of employment function is to relate the amount of effective demand, measured in terms of wage unit and directed to a given firm or the industry as a whole, with the amount of employment, the supply price of the output of which will compare to that amount of effective demand.³ The employment function shows that the distribution of effective demand for different commodities influences the volume of employment. The elasticity of employment determines the proportion of the increase in the volume of employment resulting from an increase in changes in expenditure. If the increased demand is largely directed towards the products which have a high elasticity of employment, the aggregate increase in employment will be greater than if it is largely directed towards the products having low elasticity of employment. In this context, the period of production is also significant. If the change in demand is in favour of those commodities whose supply cannot increase in short time, then the increase in employment would not be so effective for the time being. The nature of demand whether it is for investment or for

³*Ibid.*, p. 280.

consumption goods, and the nature of the firm whether it has surplus stock and excess capacity, all these would influence the volume of employment.

This is an over simplified gist of the Keynesian theory of employment but it is essential to comprehend the essentials of this theory because it provides the theoretical justification for planning, social security programmes, expansion of public sector activities, besides the pump priming activities of the government. This theory, under certain conditions, justifies deficit financing. This summary is also given in a tabular form in the accompanying chart. From this chart, it could be seen that there are many complicated items which will have to be carefully examined in order to provide a sound basis for formulating effective employment policy. The chart gives an overall view of the analysis which may be helpful for comprehending the complicated relationships. Some of the basic assumptions of Professor Keynes may also be indicated here for a better appreciation of the limitations of the doctrine. Professor Keynes has assumed as given the existing (i) skill and quantity of available labour, (ii) quality and quantity of available equipment, (iii) the technique of production, (iv) degree of competition, (v) tastes and habits of the consumer, (vi) the disutilities of different intensities of labour and of the activities of supervision and organization, and (vii) the social structure including the forces other than the independent and dependent variables set below which determine the distribution of national income.

Independent Variables

- (i) Propensity to Consume
- (ii) Schedule of the Marginal Efficiency of Capital
- (iii) Rate of Interest

Dependent Variables (Measured in terms of Wage Units)

- (i) Volume of Employment
- (ii) National Income

Practical implications of this theory are many, but here mention may be made of the inference that an increase in

effective demand, either by way of increasing consumption expenditure or of investment outlays, would increase the volume of employment. The general repercussion of such measure, however, would depend upon a large number of accompanying conditions such as the structure of existing industry, availability of unutilized capacity, distribution of income, and other behavioural propensities. Monetary and fiscal policies of the government would also be relevant in this context. Therefore, the immediate and the long-term effects of any governmental policy should be closely watched if it is expected to create any specific impact. In actual practice, when this theory is applied to an underdeveloped country, the results may not be very satisfactory. Many professional economists and economic administrators might not agree with it. But this statement warrants much serious examination. The application of this theory should be toned down on pragmatic conditions, and it should not be considered sacrosanct under all conditions and for all stages of economic development. Even theoretically, the Keynesian approach has been subjected to various sophistications. Without involving ourselves in theoretical refinements, an attempt would be made here to examine how far the application of the Keynesian approach has been successful in solving the unemployment problem in India. This examination may be meaningful in deciding whether the government economic policies could be effective in improving the lot of the Indian teeming millions.

Basic Features of Indian Labour Market

The Indian population is very large and is still increasing at a stupendous rate. According to 1951 Census, there were 361.1 million persons who increased to 439.2 million in 1961, and according to the latest estimate there were 511.3 million persons in 1967. As far as the working force is concerned, its proportion, as it would be seen

from the following table, has increased from 39.1 per cent in 1951 to 43 per cent in 1961.

TABLE 1
PERCENTAGE DISTRIBUTION OF WORKERS
AND NON-WORKERS

	1961	1951	1931	1921	1911	1901
Workers	43.0	39.1	43.3	46.9	48.1	46.6
Non-workers	57.0	60.9	56.7	53.1	51.9	53.4
Total population (millions)	439.2	361.1	279.0	251.4	252.4	239.0

SOURCE: *Census of India, 1961*, Paper No. 1, 1962.

It may be noted that 1914-18 and 1939-42 have been abnormal years with the result that population statistics as well as the pattern of occupation during these periods were seriously distorted. Within this broad limitation, however, it could be seen that the total population in India has been rising. From 239 million persons at the beginning of the present century, it rose to 439.2 million in 1961. The mid-year revised estimates prepared by the Office of the Registrar General of India have put the population as 363.4 million in 1951 as against 442.7 million in 1961 and 511.3 million in 1967. Proportion of working force which accounted for 48.1 per cent in 1911 declined to 39.1 per cent in 1951, but during the following decade, it moved upward accounting for 43.0 per cent in 1961. From these data, it would be evident that the total working population, particularly during the planning period, has been increasing rapidly.

Secondly, the agricultural sector even today, provides employment opportunity to the largest number of population. There is, however, a strong tendency among the working population to move towards the urban areas. Table 2 shows that the proportion of rural population has been declining consistently since 1921. During this period, agricultural employment has also declined. In 1921, 71.9 per cent of the total working force depended upon agriculture whereas in 1931 this proportion declined to 69.7 per cent, in 1951 to 69.8 per cent,

and in 1961 to 69.5 per cent. Thus, the dependence on agriculture has been declining when the proportion of rural population was also reduced. This suggests that during recent years, there has been mass migration of population to urban regions with increasing dependence of workers on non-agricultural occupations. It also implies that a large bulk of Indian workers are getting concentrated in a few large cities. In 1951, there were only 185 towns with more than 50 thousand population which during the next decade increased to 248. In these towns, there were, in 1951, 31.27 million persons who increased to 44.74 million in 1961. West Bengal and Maharashtra taken together contain more than three-fifths of the total industrial workers in the country. Greater Calcutta has itself given employment to more than four-fifths of the total industrial workers in West Bengal. Similarly, Greater Bombay provides employment to more than half the industrial workers in that State. Ahmedabad alone accounts for more than one-third of the industrial workers in Gujarat. The latest trend in Indian working population has been to migrate to urban areas and to concentrate in large cities and this concentration is heaviest in a few large cities of the country.

TABLE 2
PERCENTAGE OF RURAL-URBAN
DISTRIBUTION OF POPULATION

	1961	1951	1941	1931	1921
Rural population	82.0	82.7	86.1	87.9	88.6
Urban population	18.0	17.3	13.9	12.1	11.4
Total	100.0	100.0	100.0	100.0	100.0

SOURCE: *Census of India, 1961*, Paper No. 1, 1962.

Thirdly, the percentage distribution of workers by industrial categories indicates that the main changes have occurred in the category of trade and commerce, and in the manufacturing industries. In other categories, the proportion during the decade 1951-61 has remained more or less the same. The employment in trade and commerce has declined by 1.1 per cent whereas by the same amount it has increased in

the manufacturing and mining sector. One may, therefore, infer that there has been a shift from trade and commerce to factory employment.

TABLE 3
PERCENTAGE DISTRIBUTION OF WORKERS BY
INDUSTRIAL CATEGORIES

	1961	1951	1931	1921	1911	1901
Agriculture	69.5	69.8	69.7	71.9	70.9	67.6
Manufacturing, mining, forestry, fishing, plantation, etc.	13.2	12.1	14.1	13.9	14.8	16.1
Construction	1.2	1.0	1.2	0.8	1.0	0.8
Trade and commerce	4.0	5.1	5.5	5.8	5.4	6.0
Transport and communication	1.6	1.5	1.0	0.8	1.0	1.1
Others	10.5	10.5	8.5	6.8	7.5	8.4

SOURCE: *Census of India, 1961*, Paper No. 1, 1962.

The increase in factory employment has been due to increasing attractiveness of the sector. During the fifteen-year period beginning with 1951, factory employment has increased from 2,914 thousand persons in 1951 to 4,585 thousand persons in 1964 showing an increase of 55 per cent. In mines and plantations, such spectacular increases have been absent. Only marginal adjustments have taken place in mines whereas in plantations the employment has slightly declined. The difference between employment increases in factory establishments and other sectors of the economy is also explained by the fact that the wage rate in factory sector may not be relatively higher than the rates prevailing elsewhere but the working conditions there are much better. Average annual earnings of industrial workers have considerably increased during the last twenty years or so, whilst those of others have markedly lagged behind. Per capita national income at current prices was Rs 266.5 in 1950-51, which increased to only Rs 333.6 in 1961-62, whereas annual average earnings of industrial workers increased from Rs 959 in 1950 to Rs 1,479 in 1963. But, it may also be noted that

adult male workers in tea plantations in Assam valley earned Rs 245 in 1950-51 which rose to Rs 596 in 1961-62; the coal miners earned Rs 678 in 1950-51 which increased to Rs 1,389 in 1961-62. Thus, the wage rates in certain categories of employment other than factory establishments have got better share and the wage rates there have increased substantially. Nonetheless, compared to the per capita national earnings, these three categories of workers have begun receiving much better deal. But these have to be considered along with the fact that the advantages accruing in factory establishments which have been absent in mines and in plantations. Additional job opportunities in mines and plantations have also been limited compared to those in factories. These explain the greater popularity of factory employment.

TABLE 4
EMPLOYMENT IN FACTORY, MINES
AND PLANTATIONS

	Unit '000			
	1951	1956	1961	1964
Factory employment	2,914	3,433	3,928	4,585
Mines employment	549	629	671	687
Plantation employment	1,236	1,200	1,210	1,210
Total	4,699	5,262	5,809	6,482

SOURCE: *Employment Review*, Director General of Employment and Training, New Delhi.

Fourthly, the public sector has been emerging as an important employer. During the last twenty years or so, the Government of India has set up many industrial undertakings. The State governments have also undertaken similar activities. Moreover, the government has to employ a large number of people in different types of activities. Even the task of economic administration has grown onerous. As a result of the proliferation of governmental activities and more secured terms of appointments, the attractiveness of public sector employment has been increasing. In fact, it has not been so much the lack of attractiveness as much the lack of expand-

ing opportunities in the private sector with emphasis on personal loyalty and get-going duties which have put the employment in this sector as second preference for certain types of workers.

The rate of growth of private sector employment has, therefore, been declining. In 1956, the public as well as the private sectors employed about 5.2 million workers each. But the ratio soon changed. In 1961, there were 7.05 million employees in the public sector, whereas the private sector employment accounted for only 5.8 million. In 1965, there were 8.96 million persons employed in the public sector, whilst in the private sector it rose to 6.03 million. In 1966, the public sector employed 9.38 million persons and in 1967, 9.63 million persons whilst for these years, there were only 6.81 million and 6.70 million jobs in the private sector.

Within the public sector itself, the employment growth rate has been highest in quasi-government establishments followed by local bodies. This has been due to the establishment of a large number of industrial and commercial undertakings having a bearing on economic growth. This category includes even such autonomous establishments as Steel Plants, Heavy Electricals, Life Insurance Corporation, and State Trading Corporation which are controlled and financed wholly or substantially by Central and State governments. In this category such institutions which are primarily of the research type as National Productivity Council, the Institute of Foreign Trade, and others have also been included. Table 5 shows the rapidly increasing tempo of employment in public and private sectors during the last few years.

Fifthly, the significance of self-employed persons has also been increasing. The data (Table 5) on private sector employment do not take into account the persons employed in small scale sector. Employment in this sector has substantially increased during recent years. Besides, a large number of engineers and such other technicians and technical persons have also

TABLE 5
PERCENTAGE CHANGE OF EMPLOYMENT OVER THE
PREVIOUS YEAR IN PUBLIC AND PRIVATE SECTORS

	Public	Private
1961	-	-
1962	5.2	2.4
1963	7.1	5.8
1964	6.3	5.9
1965	6.0	4.5
1966	4.5	1.0
1967	2.7	(-) 1.9

SOURCE : *Employment Reviews*, Directorate-General of Employment and Training, New Delhi.

been setting up their own business concerns. Within the next few years, the significance of this type of employment will considerably increase.

Lastly, the female workers are increasingly entering almost every sphere of the labour market. In earlier times, female workers were available in tea plantations and in some casual and agricultural sectors. They were also found in educational institutions. As an organized group with special problems of their own, they became important only after the Second World War. Since then, they have begun competing with male workers in almost every category of employment. During recent years, however, this trend has gained momentum. The total number of women employees of different categories at the end of March 1966 was 17.4 lakh as against 13.7 lakh in March 1962 showing an increase of 27.1 per cent during the four years period. In March 1967, there were 18.2 lakh women employees in the country. The female employment in the public sector has also been increasing. This has been mainly due to the recruitment of teachers in various States, expansion of medical, health, and family planning activities and to some extent in construction and soil conservation work. The employment of larger number of female workers in different categories of jobs has created many new problems. These have been very complex problems having far-reaching

consequences on the economic and social life of the country.

Impact of Planning

On the eve of independence, the employment situation in India was pretty bad. Employment Exchange figures of registered work seekers do not adequately reflect the unemployment situation in the country. They do, however, in some way indicate the general situation in this regard. These figures showed 70.8 per cent increase in the number of monthly registrations during 1948-53, whereas the placements by the Exchanges declined by 23 per cent. The number of vacancies outstanding by the end of the period declined by 42 per cent. These data are not very reliable, but they do reflect the difficulties of the job seekers in finding suitable employment. Between 1948 and 1950, the index of industrial production declined by more than 3 points: from 108.4 in 1948 to 105.0 in 1950. Cotton textiles, woollen manufactures, and jute manufactures suffered heavily. These industries were mostly located in Calcutta and Bombay where there have been heavy concentrations of factory workers. Consequently, the general morale of workers had been low. The first half of 1949 characterized diminishing employment opportunities and uncertainty. The chief causes for this instability had been the shortages of raw materials and capital goods, inadequate supply of power and coal, and an unfavourable transport situation. Many other factors also accentuated the difficulties. The Central and the State governments had sponsored various retrenchment measures. Anti-inflationary measures were also adopted. There were restrictions on jute supply from East Pakistan; stocks of various items were also piling in several establishments. In Bombay alone, over 40,000 persons lost their jobs; in Uttar Pradesh, over 9,000 workers were affected. About 12 factories in Bombay employing not less than 1,400 persons were completely or partially closed. Similar closures occurred even in Delhi. Coal mining districts showed signs of persistent trouble. Plantation industry also had surplus labour. Thus, there was a general depression

prevailing in the labour market when the country was taking stock of her problems soon after independence.

The establishment of the Planning Commission early in 1950 and the announcement of the various projects to be initiated by the Government of India had a very healthy influence even on the production programme of the private sector. It mirrored a better employment prospect for the coming years. However, the beginning of the planning was not considered the final answer. The process of planned economic development was full of difficulties. Dr Gyanchand, the author of *India's Teeming Millions*, stated that the agriculture cannot thrive and become progressive unless the surplus population on land is taken off it. Industry, which alone could provide the alternative means of livelihood, cannot be developed because the products of industry cannot be purchased by agriculturists owing to their poverty.⁴

Similarly, Bimal Ghose also expressed his fears when he said that a policy of rapid industrialization in an agricultural country entails heavy sacrifices and sufferings on its peasant population. The problem poses itself in the form of agricultural raw materials as much for feeding a rapidly growing number of urban workers as for exports with a view to paying for the importation of necessary capital equipment. In fact, this was the most difficult problem according to Bimal Ghose that the planners had to tackle.⁵ J.R.D. Tata, Dr Matthai, and Dr Gyanchand thought that the problem of unemployment was so severe in India at that time that it could not be effectively solved unless proper measures for population control were implemented. Mr Tata very strongly pleaded for early steps to be taken for undertaking a continuous and scientific study of the vital problem in its biological, economic, and social aspects. The control of population was "necessary to enable constructive work to bear fruit." Dr Gyanchand argued that the socialist reconstruction

⁴Gyanchand, *The Population Problem*, Oxford University Press, Bombay, p. 22.

⁵Bimal C. Ghose, *Planning for India*, Oxford University Press, Bombay, p. 56.

would fail to solve the problem set by it unless population explosion was controlled. According to him, there was no escape from the conclusion that "restriction of numbers is essential for the remaking of the nation."

Despite the various difficulties and ideological controversies facing the Planning Commission in the formulation of its programme, many events occurred at that time which ameliorated the unemployment situation to a considerable extent. The conclusion of Indo-Pakistan Agreement in 1950 which facilitated the movement of goods between India and Pakistan created increased confidence among all sections of the community which tended to give fillip to industrial and business activities. Higher employment in Jute industry could also be possible. In August 1950, before the general strike in the cotton mill industry, as many as 126 mills were working in 3 shifts as against 92 in May 1950. The number of workers on rolls of these mills increased from 747,695 in March 1950 to 770,238 in July 1950. During the same period, the average daily employment rose from 678,379 to 701,417.

Better employment opportunities were available in non-industrial sectors as well. Fresh avenues of employment were found in railways, post and telegraph, and the Indian army corps. The establishment of the Government Housing Factory and the expansion of the Central Tractor Organisation helped the absorption of some unemployed persons in Delhi. In Uttar Pradesh, the expansion of government roadways, the establishment of Panchayati Raj offices and the recruitment of primary school teachers offered welcome relief. The work relating to the Damodar Valley Project which was slowed down during the previous year was accelerated with the building of dam at Tilaiya and Konar and with the installation of a thermal power plant at Bokaro. These provided employment opportunities to a large number of workers. The electricity expansion scheme of the Bihar Government which was linked with the Damodar Valley Project also entered its first stage. The completion of the Sindri Fertilizer Factory also showed hopes of new em-

ployment opportunities. In West Bengal, the Chittaranjan Loco Manufacturing Works, which started working, offered further employment. In Orissa, many persons could be employed in the Hirakud Dam Project, and the Machkund Hydro-Electric Project. In the Punjab, the Bhakra Nangal complex of projects added employment opportunities in that State. The several projects undertaken by the Public Works Department in Saurashtra offered additional scope for employment to nearly 10,000 persons. The Sindh Valley Hydro-Electric Project and the irrigation projects which were initiated in Kashmir provided employment opportunities there to as many as 10,000 workers.

As a result of these schemes, the employment situation in 1951, in spite of certain difficulties, improved substantially. The influx of displaced persons which had reached its peak by the end of June 1951, continued up to the middle of September that year though at a reduced rate. Employment in factories, government offices as well as in national projects increased. In this way, the initial impact of planning was considered favourable. But, even at the time of the formulation of the First Five Year Plan, the magnitude of unemployment was not precisely assessed. It was roughly estimated that the rural unemployment was as high as 30 per cent, besides chronic underemployment, in those regions. It was expected that the improvement in the employment situation in the rural areas would have a salutary effect even on the employment situation in the urban sector. The Planning Commission wanted to solve the unemployment problem in a comprehensive manner. The failure to achieve substantial results, however, depended on several complicated situations. It was realized that employment implied utilizing the available manpower for some productive purpose. It involved provision of gainful employment to the available working force, shifting of workers to those job opportunities where they could have better earnings enabling them to have more satisfying jobs, and improving the technical skill of the workers for performing better quality of work.

The problem was recognized as that of increasing the marginal productivity of labour, so that there was no under-utilized manpower at the prevailing wage rate. It was expected that the placement of the workers should be such that further substitution of workers by capital equipment or shifting them to other jobs should not yield higher productivity. It was also necessary that the provision was made for the marginal productivity of the factors of production to gradually increase which was the primary purpose of all planning processes. It implied that the task before the Planning Commission was to regulate the number of persons seeking jobs, that is, to regulate and control the supply of labour and to increase the demand for them. But, the available working force in the country could not be considered as a homogeneous mass: the supply of and the demand for different types of workers differed markedly. The question of manpower planning involved assessing the requirements of different categories of workers and to arrange supplying them to the appropriate jobs. Employment problem in this way became more a sectoral problem in the sense that the unemployed engineers could not be utilized as medical practitioners, or that an agricultural worker could not be pushed to the assembly line of a tractor factory without any job reorientation.

During the First Five Year Plan, the Planning Commission hoped to attack the unemployment problem on three fronts, namely, rural, urban, and educated. In India, in common with other underdeveloped countries, unemployment arises as a result of shortage of land, capital equipment, and other supplementary resources. The problem of unemployment and underemployment had been in evidence for a long time. The main factors which had aggravated it were the rapid growth of population, the disappearance of old rural industries, inadequate development of the non-agricultural sector and the large displacement of population as a result of Partition. About educated unemployment also, the Planning Commission was of the opinion that it was a chronic phenomenon of the Indian

labour market. The Second World War had temporarily relieved the situation but after the war, the problem had again become acute.

Based on these three main characteristics of unemployment prevailing in India at that time, the Planning Commission envisaged that the activation of the rural economy and strengthening of the agricultural sector and the reduced pressure of urbanization would have a salutary effect on urban employment. Among the measures proposed to be taken by the Plan to reduce the incidence of rural unemployment mention may be made of the major and minor irrigation works, large-scale land reclamation schemes and the revival and development of village industries and handicrafts, all of which have found a central place in the rural development programmes because of their potential for absorbing a large number of people and low capital and skill requirements.

The Planning Commission hoped that the revival of small-scale industries especially those which had complementary role to play in large-scale industries could mitigate rural as well as urban unemployment, to a great extent. The First Plan stated:

Urban areas are also confronted with the same problem, which has been made worse after the end of the war because of the difficulties faced by a number of small-scale industries. The solution of this lies to some extent in the extension of the existing large-scale industries and establishment of new ones. Along with this, suggestions are made in the Plan to assist the existing small-scale industries and also to encourage the starting of similar industries, especially those industries which can serve as complementary to large-scale industries.⁶

The plan did not envisage any radical solution of the educated unemployed; nonetheless, it formulated certain measures aimed at relieving the problem to some extent.

The Plan placed emphasis on increasing agricultural production and, at the same time, on creating a base for industrial

⁶*First Five Year Plan (Summary)*, Planning Commission, New Delhi, p. 133.

expansion. This limited the immediate expansion of employment opportunities for the educated class. Nevertheless, some short-term remedies were necessary to provide relief to this class for which the following measures were suggested: (a) the pay offered to technical personnel, e.g. engineers and doctors, were to be consistent with the cost of training, and inducements such as subsidies for private dispensaries in villages should be offered; (b) utility to employers of certain university degrees, e.g. of commerce, should be increased by supplementing the present theoretical knowledge imparted in colleges by practical training; (c) educated persons should be persuaded to rid themselves of prejudice against manual employment and they should also be encouraged to receive sufficient training for manual jobs; (d) persons without experience should be enabled to receive apprenticeship training. On the other hand, older people may find it difficult to get employment both in public and private sectors, some reservation for such persons should be made in public service while the private employers should be persuaded to engage such people, especially those with family responsibilities; and (e) vocational counselling and guidance services should be developed to advise young persons to choose vocations according to employment possibilities.

In addition to these measures it was necessary that there should be a reduction in the number of job seekers. The following steps were suggested in this direction: (a) a list be made of small-scale industries which could be started by the educated class with amounts of capital ranging from Rs 500 to Rs 5,000. The government should help them by advancing loan for the initial capital and by providing vocational facilities; (b) a beginning has to be made in establishing trading estates providing factory sites or built factory premises with such facilities as transport and the supply of electricity, water, gas, etc., on the lines of those in the United Kingdom. Such trading estates and centres of production were considered

important for giving a major direction in this regard.⁷

The above-mentioned strategy for tackling the unemployment problem in India continued with more or less the same emphasis in all the subsequent plan periods. Even in the Third Plan, the problem was tackled on these three fronts. The Third Five Year Plan stated that the problem should be approached on three main directions, namely, within the framework of the Plan efforts should be made to ensure that the employment efforts are spread out more widely and evenly than in the past, and a fairly large programme of rural development should be undertaken and that small industries should be encouraged. The main difference between the Third Five Year Plan and other preceding plans had been its recognition of the fact that the employment objectives should be viewed in the perspective. The Planning Commission estimated that the increase in the labour force over the next 15 years might be of the order of 70 million which consisted roughly of about 17 million in the Third Plan, about 23 million in the Fourth, and about 30 million in the Fifth Plan. *This, in a way, pointed out that the problem of unemployment in India is so colossal that even during the next few decades there is no hope for accordg any appreciable relief*

At the beginning of the First Five Year Plan, the unemployment situation had showed marked improvement, but the situation soon turned adverse. During 1953, the unemployment situation, specially in the urban sector, deteriorated and some additional measures in order to counteract the mounting unemployment situation became necessary. The National Development Council considered the seriousness of the situation in November 1953 and decided to revise the plan outlay upwards. The adjustments *inter alia* aimed at assisting scarcity areas, State Finance Corporations, cottage and small scale industries, expansion of power facilities, water supply to cities, and the development of roads. In addition to these, programmes of permanent improvement in chronic scarcity

⁷*Ibid.*, pp. 135-6.

areas, rural and urban electrification schemes, and urban rural water supply schemes were also approved. These schemes were expected to relieve unemployment in the country. This showed the influence of the Keynesian doctrine of pump-priming on the Indian Planning Commission.

Impact of these programmes on the unemployment situation of the country to some extent was favourable, but the condition from the long-term view continued to be disturbing. In fact, no plan has been able to absorb even the new entrants during the plan period to gainful employment. The First Five Year Plan envisaged provision of employment opportunities to more than 5 million persons; of this, 2.3 million additional jobs were in the agricultural sector and 2.7 million in non-agricultural sector. But, the back-log of unemployment at the beginning of the Second Five Year Plan amounted to 5.3 million. The Second Plan envisaged provision of employment opportunity to about 8 million persons. Thus, the Planning Commission Report accepted that the Second Plan, even if implemented to the full, would fail to give employment to all the new entrants to the labour market.

At the beginning of the Third Five Year Plan, the back-log of unemployment reached 9 million and 17 million additional entrants were expected during this period. The plan, however, envisaged to provide additional employment opportunity to only 14 million persons thus leaving about 12 million unemployed persons at the beginning of the Fourth Five Year Plan. The Draft Outline of the Fourth Five Year Plan estimated a back-log of 14 million unemployed at the end of the plan while there were 23 million new entrants during that period. Thus, though the precise estimates of unemployment have not been available in the country yet the data on new entrants during the different plan periods and the jobs provided to them show that the situation has been deteriorating consistently with the introduction of every five yearly plan. The back-log of unemployment which accounted for 5.3 million by the end of the First Five Year Plan may be around 14 million by the end of

1970-71. This, however, does not take into account increases in underemployment.

TABLE 6
BACKLOG OF UNEMPLOYMENT AT THE END
OF DIFFERENT PLAN PERIODS

	<i>Million</i>
<i>At the end of</i>	
First Plan	5.3
Second Plan	9.0
Third Plan	12.0*
Fourth Plan (1966-71)	14.0

*The Draft Outline estimated only 10 million.

SOURCE : *The Plan Reports*, Planning Commission, New Delhi.

Policy Implications

The main justification for adopting planning machinery for regulating economic development springs from the Keynesian approach to unemployment and economic fluctuations occurring in a free society. The Indian experiment has, however, showed its inability to satisfy any one of these objectives. Unemployment situation in the country has worsened since the beginning of the planning. There have been many causes for this deterioration. The Keynesian emphasis on increasing public outlays for augmenting effective demand in the economy stressed merely one of the many aspects of the problem. The Indian planners have been very eminent economists and their understanding of the economic theories and monetary implications has been profound. Nonetheless, they seem to have missed the uneconomic forces invading planning decisions.

It is true that the total income in a community equals the amount of output produced multiplied by its price during any given period. This should also equal the number of persons employed multiplied by the (average) wage level. This is, however, an over-simplification because it assumes the possibilities of resolving all factors of production in terms of labour. This identity would suggest that the volume of employment (E) depends upon

the level of output (O) and the relative price (p)=wage (w) ratio.

That is, $E = O \frac{p}{w}$. This identity indicates that output remaining constant, if wage rate increased more than the price rise, there will be adverse effect on the level of employment. In Indian situation, price and wage both have been rising rapidly. One is inclined to believe that prices have been leading the race. As such, most of the increases in employment opportunities have been due to inflationary pressures. Increases in output have also provided additional employment. If wages were not allowed to rise, employment might have showed much greater expansion.

Under Indian conditions, the market is not perfect. Even the labour market is not so. Nonetheless, there has been horizontal mobility of different categories of workers; this, in fact, has been more significant than vertical mobility. This has led to shifts in the different categories of the workers from one place to another. The question of rural urban unemployment can be viewed as a problem of mobility of agricultural workers who are mainly unskilled workers to another (urban) region causing unemployment of unskilled workers in urban areas. But, once they become (unskilled) industrial workers, their response to prices, wages, productivity, etc., significantly alters. That has been the result of factory-ization or urbanization of workers.

For our present purpose, we may consider the entire economy as consisting of two sectors, namely, agricultural and non-agricultural. Let employment in the former be denoted as E_1 and in the latter as E_2 ; similarly, the output in the former as O_1 and in the latter as O_2 ; therefore,

$$E_1 + E_2 = O_1 \frac{p^1}{w_1} + O_2 \frac{p^2}{w_2}$$

But, wages in the agricultural sector (w_1) depend upon the wages prevailing in the industrial sector (w_2). Industrial wages depend upon the prices of consumer items prevailing in the market. Consumer expenditure of the industrial workers

consists of expenditure on foodstuffs as well as manufactured items. Prices of these items have been rising rapidly and there has been no expectation of achieving stability in this regard. Therefore industrial wages also have been rising. Rising industrial wage-rate has to be reflected in increasing productivity, otherwise, there could be retrenchment within the limitations imposed by labour legislation and trade union influence. Gheraos reflect pressures for increasing wages without corresponding increases in productivity.

But, agricultural wages do not have any direct relationship with productivity in this sector. Employment of agricultural workers does not depend much on the marginal output of the workers in that sector. Agricultural inputs do not so much influence the price of agricultural outputs as in the case of industries. And it would be erroneous to relate the agricultural wages with agricultural prices. Agricultural prices and agricultural outputs also do not have so much of direct relationship with each other. Not the procurement prices and minimum support prices but the *expectations* relating to them in a vague and general way determine the area of cultivation under different types of crops, and the output accruing from this area depends upon several economic and non-economic factors in contradistinction with the industrial manufactures. This situation suggests that agricultural wages are very sticky. Therefore, when prices of agricultural and manufactured articles are rising, as has been in the case in India during the last twenty years or so, there would be mobility of workers from agricultural to industrial regions. The rural works schemes and the rural industrialization programmes do not take these basic features into account, and as such, they have failed to make such impact.

The Keynesian recommendation relating to the public expenditure policy does not hold good in an underdeveloped economy of the Indian type. Lack of monetization and commercialization does not allow money injected in the economy to circulate freely. Consequently, it leads to whirlpool of money

circulation in limited areas. This fact is already well recognized. But, the Keynesian approach should be viewed from another angle as well. The public expenditure policy should be adopted to this overall view. Total income in a country is an (approximate) aggregation of personal and public expenditures plus surplus in balance of payments. Personal and public expenditures are either on consumption items or on investment goods. Investment goods do not have an end by themselves; they are incurred because they are needed to produce consumer goods. The amount of expenditure on investment goods and the pattern of distribution of the investment outlays would ultimately depend upon the nature and extent of consumer demand anticipated during any period. In India, the level of consumer expenditure has been so much "throttled" that the real incentive for production does not come through. Once consumer expenditure is not given free play, desire to export and to earn foreign exchange is also reduced. This has been further accentuated because imports are not related to export efforts of the individuals. Import requirements of different sectors give fillip to export incentives, but in an era of controls and regulations exports and imports of the country are assessed and permitted independent of one another. Thus, by disrupting the natural invisible regulatory interconnections between consumption and investment outlays with their relationship with external trade, the resilience of the economy has been minimized. As a result of this de-linking, the multiplier effect of which Keynes spoke of has not been given a free play. In absence of this expansionary tendency assumed in the Keynesian analysis, it is not logical to expect substantial expansion in employment opportunities following large amount of public expenditure in India.

There is another aspect of the problem too. Keynes emphasized the importance of marginal efficiency of capital. In essence, this is an *estimation* of the *expected* yield from the use of certain types of capital equipment. In an era of uncertainty about the allotment of raw materials, restrictions over fuller utilization of the existing industrial capacity and

frequent labour-employer conflict, it is difficult to venture any stable expectation of the future return on one's capital investment. This, in its turn, reacts adversely on the employment situation. Moreover, the yield from employing additional workers, in view of threats and uncertainties in the economic situation, would induce the entrepreneurs to go in rather for assured amount of limited profit (though exorbitant in existing Indian condition) than to embark upon expansion programmes, and risk gharaos, underutilization of capacity, and reduced profit. Labour difficulties have already initiated a tendency among the industrialists to set up capital-intensive projects as far as possible. As a result of these factors, the industrialization of the country has not assisted the expansion of employment opportunities as much as it could have done otherwise.

CHAPTER X

FOREIGN AID

THE PROBLEM of foreign aid is so full of political overtone that its objective examination often becomes difficult. The donor countries have their own historical, ideological, economic, military, and sociological considerations in offering external assistance. Even the developing countries have their own fears. Having recently attained political liberation, they wish to avoid any further domination—economic, political, or otherwise—due to the flow of external assistance. Furthermore, foreign technical collaboration, which has been an important aspect of foreign aid, has generated so much heat that its beneficial influences are generally overlooked. The question of foreign aid being so much psychologically involved, should be approached rather carefully.

The disillusionment with external aid is making the industrialized countries reticent in granting additional doses of the same. The level of foreign aid envisaged during the development decade has not been forthcoming. The developing countries have been reconsidering their strategy. The flow of external aid has been drying up. The terms of assistance have become harder. The “grant” has almost vanished. The developing countries are, therefore, experiencing difficulties in replenishing their foreign exchange reserves. This difficulty is likely to increase in future. During the next ten years or so, the quantum of bilateral foreign assistance might significantly decline. The limited assistance would be available only through the international agencies. When that happens, the approach to external aid would be entirely different.

Types of Foreign Aid

Presently, there are three main types of external assistance. These are: capital aid, technical aid, and commodity assistance.

The different forms of external assistance have different implications. The various kinds of foreign aid are needed in order to cater for the varying needs of developing countries. The inability of underdeveloped countries to pay for their growing requirements of machinery and industrial inputs, and difficulties in acquiring technical know-how already acquired in advanced countries, and the paucity of essential consumer goods such as foodgrains, milk-products, and medicines whose demand cannot be unduly postponed have been the main causes for seeking different kinds of external assistance. But, the developed countries also have their own limitations. The total supply of different kinds of foreign aid depends upon the conditions prevailing in donor countries and has to be related to the total needs of developing countries. Effective external assistance depends on the matching of the two.

Motivations for Foreign Aid

The basic reason for assisting an underdeveloped country is a growing awareness among the advanced countries that they must share their prosperity with other developing countries. On the other hand, the non-industrialized nations find it difficult to obtain their requirements on strictly business terms: they are not in a position to pay for all their imports. Therefore, they need special arrangements for meeting their requirements. By providing external assistance, the advanced countries agree to supply the much needed foreign exchange resources in such a way that the immediate needs of the developing countries are met and they are permitted to pay back the debt obligations later when they are in a better position to do so. In this process of helping the developing countries, the advanced countries also derive certain advantages. There have been political, economic, military, and several other considerations which induce the advanced countries to make foreign aid available to the developing countries.

Political motivations are not necessarily connected with controlling the economy of the aided country. These do not

imply any desire to influence the administrative decisions of the developing country either. They generally refer to historical or ideological affinities between the donor and the assisted countries. As a result of such associations, the advanced countries offer a large bulk of external resources for the development of the other. Take for example, the case of Great Britain and France. During the last two centuries or so, they have been the most important colonial powers. Now, they have relinquished their imperialist domination. But, they wish to maintain their traditional and historical alliances. For this reason, a close economic tie between the mother country and the colonies is still maintained. This close relationship is reflected in the quantum of bilateral aid offered by the United Kingdom and France to their erstwhile colonies. In 1964-65, 87 per cent of the British external assistance was directed towards the Commonwealth of Nations; and 96 per cent of the French bilateral assistance in 1962 went to the Franc Zone countries.

Ideological considerations in mobilizing external assistance can be seen in the United States programme of assistance to Latin American countries. Even the European Recovery Programme for the reconstruction and development of the war-ravaged West European countries as well as the United States assistance to the South East Asian countries are primarily guided by strong anti-communistic sentiments. The communist countries have also been exploring possibilities for extending their sphere of political influence. The Chinese assistance to Nepal, Yemen, Tanzania, and other Afro-Asian countries has been motivated by ideological considerations. The Soviet Union has also similar considerations guiding her foreign aid policy. Even in the case of Japan, it has been stated that the urge to establish political and economic hegemony has been one of her motives in extending external aid.

Such considerations can endure only on the basis of firm reciprocal relationships. Any concessions granted to the backward and underdeveloped countries

must, in some form or the other, provide corresponding gains to the donor countries. This is important because altruism by itself is not sufficient. All forms of external assistance must be accompanied by some form of financial and trading advantages to the donor country. There are many forms of advantages that the donor country might be seeking. In earlier periods of colonization, the rubber plantation and tin mining were fostered in South East Asian countries with a view to assisting the industrial development in the mother country. Expansion of the Indian Railways during the nineteenth century was primarily motivated by the objective of providing cheap transport facilities to industrial inputs required by the British industries. Similar gains have induced even the European Common Market in giving special facilities to its African associates. The Japanese credit for developing iron ores in India, the Chinese deal for importing rubber from Ceylon, and the American stipulation that a portion of P.L. 480 fund should go to help the associates of American business firms are examples of economic motivations.

There are three other types of economic relationships which may be considered in the present context. First, the association between certain countries may be for market integration. An example of this kind of association has existed between France and the Franc Zone countries. The war ravaged France could hasten its recovery as a result of its association with the African Franc Zone countries. They needed capital goods and other items produced by France. The Franc Zone countries provided expanding market opportunities to France. In many cases, the association of underdeveloped countries with industrialized nations has been with a view to integrating the market possibilities of the two.

The second type of relationship is forged under foreign collaboration. Under this kind of arrangement, the foreign collaborator provides technical know-how, technical details of special manufacturing processes, blue-prints and drawings for the manufacture of different parts and components, training

facilities for artisans from the developing countries, besides providing capital goods against equity participation, royalty payments, etc. Sometimes, payments are even made for the use of brand names. Foreign collaboration might give the overseas industrialists an opportunity for participation in the financial control and administration of the industrial undertakings established in developing countries. Such relationships might secure better market prospects for parts and components of the machinery supplied to the latter. Besides, this association gives the collaborators an opportunity for gaining wider experience and thereby making them better acceptable to other developing countries.

Thirdly, the association might strengthen the national currency of the participating countries. Every country wants to maintain stability in the par value of its currency. Foreign exchange reserves are important for strengthening the national currency. For this reason, the Sterling Area has continued for so long. The various blocs directly and indirectly aim at this objective. Under such arrangements, gains in foreign exchange reserves by one country may be offset by deficits incurred by another without creating serious imbalance for the group as a whole. It has been stated that the francification of the erstwhile French colonies in Africa was suggested on similar considerations. The supremacy of American dollar, German deutsche-mark, French franc or of the British sterling has been primarily established due to such economic support.

Another important basis of external assistance connected with maintaining ideological supremacy has been military alliances. The countries belonging to various military alliances such as NATO, SEATO and other defence groupings have received a fair amount of foreign aid primarily due to their adherence to specific military pacts. Turkey, Korea, Viet Nam, and Pakistan are examples in this regard. This form of assistance does not only imply supply of military hardware but assumes provision of many types of facilities during the period of emergency. The present-day defence preparedness requires securing foot-

holds at strategic locations, permission for establishing defence installations, facilities for meteorological observations, radar facilities, communication support and many other arrangements. They may seem innocent arrangements during peace time but at the outbreak of hostilities such reciprocal arrangements are of immense advantage. Unless the strategically located countries are friendly, effective manoeuvrability of the army could be seriously impeded. This clearly explains the special importance attached to Nepal, Afghanistan, Pakistan, Turkey, and Viet Nam. These are the countries where foreign aid has been pouring in abundantly. For such considerations, the United States offers 30 per cent and the USSR 25 per cent of their total bilateral assistance by way of direct military aid.

Foreign Aid to India

The Indian experience in mobilizing external aid for her programmes of economic development has provided an interesting example of different motivating forces inducing foreign aid. Many countries with different shades of political ideologies have contributed to Indian developmental efforts. Different objectives have led them to assist India. Probably, it has been its strategic location and political neutrality that led the donor countries to supplying appropriate types of assistance in sufficient quantity to it.

Authorization of Foreign Aid

By the end of September 1968, the total authorization of external aid to India, as given in Table 1, amounted to Rs 8,461.52 crores. Of this, Rs 972.99 crores, or 11.5 per cent was offered by the USSR along with other East European Socialist countries and Rs 4,279.74 crores or 50.4 per cent by the United States of America. The US aid, thus, amounts to more than four and a half times the assistance authorized by the Socialist countries. Four of the Commonwealth countries, namely, the United Kingdom, Canada, Australia, and New Zealand taken together have contributed more than the aggregate aid authorized by the Soviet

and the Socialist countries. West Germany has been another substantial contributor to India.

The table also shows utilization of external aid from different countries. It is significant to note that 93.4 per cent of the US authorization has already been utilized, whereas the utilization of the Soviet aid has amounted to only 40.5 per cent. This suggests that the Soviet aid has not been closely tailored to the needs of India, whereas the bulk of the US aid is aptly related to the Indian requirements. Utilization of the German aid amounted to 86 per cent. and that of Japan 93.1 per cent. An important feature of the Japanese assistance has been its close linkage with the development of iron mining in which Japan has been vitally interested.

The United States has offered Rs 172.65 crores as "grants," whereas Canada has contributed Rs 268.41 crores as such. But, the "grant" element of foreign aid has recently been declining. During the First Five Year Plan, 36 per cent of total assistance accounted for grants which declined to 18 per cent of the total during the Second Five Year Plan and to only 4 per cent during the Third Five Year Plan. The Socialist countries, as a rule, do not offer grants, though some of them have done so. Such assistance from this group of countries has amounted to only Rs 8.22 crores. Details of this break-up are not given in the table; but this point should be kept in view while examining assistance from different countries. While studying this table it should also be kept in view that the value indicated therein has been converted into Indian rupees as a result of which some awkward situation has arisen. For example, when utilization has exceeded authorization, this has been due to the discrepancy existing at different points of time in the par value of the Indian currency.

During the last few years, fresh authorizations have been declining. Even the *Economic Survey 1968-69* has recorded that

there has been a substantial decline in fresh authorizations of foreign assistance during the last eighteen months. These

amounted to only \$ 982 million in 1968-69 as compared to \$ 2,136 million in 1966-67. . . . This sharp drop in authorizations of fresh aid was due to several reasons. The USSR and other East European countries had authorized aid in 1966-67 for a five-year period, and only Bulgaria among these countries made any fresh commitment subsequently. Similarly, the International Development Association was not able to announce any authorization in 1967-68 because its resources had not been replenished by its members. Finally, US assistance was lower due to a reduction in the overall US aid appropriations.¹

This shows that the general trend in the flow of external aid has not been liberal.

Utilization of Foreign Aid

The utilization of foreign aid gained momentum, generally speaking, with the beginning of the Second Five Year Plan, and more particularly after the foreign exchange crisis in 1957-58. During the First Five Year Plan foreign aid, amounting to only Rs 201.67 crores, was utilized. This, on an average, was of the order of Rs 40.33 crores per year. During the Second Plan period the utilization of external aid increased seven-fold. The total utilization during the quinquennium 1956-61 amounted to Rs 1,430.19 crores giving an annual average of Rs 286.04 crores. The total aid utilized during the five years of the Third Plan amounted to Rs 2,867.52 crores with an annual average of Rs 573.50 crores, but amounting to Rs 768 crores during 1965-66. During the following two years, the level of utilization increased to Rs 1,052.82 crores and Rs 1,189.73 crores respectively. Thus, it is obvious that the Indian dependence on external aid has been gradually increasing with every year of the plan implementation. This is specially disturbing when the country has been planning to reduce her dependence on external assistance drastically, to about half of it, net repayments, by the end of the Fourth Plan period.

¹*Economic Survey, 1968-69*, p. 37.

more and more difficult to obtain foreign aid: the Aid India Consortium authorized only Rs 717.79 crores in 1967-68 as against Rs 1,093.74 crores in 1966-67. The interest charges on different loans have also been rising. The Agency for International Development, the main source of development assistance from the United States, used to charge $3/4$ per cent interest rate for loans authorized prior to 16 December 1963 but it has subsequently raised it to 1 per cent for the first 10 years and 2.5 per cent for the remaining 30 years. The development loans extended by Canada, France, Italy, and West Germany now carry an annual interest charge of between 5 and 7 per cent, which by no standard can be considered "soft." Even the terms of assistance from the East European countries, and the Soviet Union though subject to an interest charge of only 2.5 per cent per annum require the payment of the principal and the interest to begin within one year of the completion of deliveries, irrespective of the stage of production. These are by no means easy terms of foreign aid.

Besides, the machinery and equipment supplied under external assistance are not necessarily at the internationally competitive rates. In their paper on *Factors Reducing the Value of Foreign Aid*, Tapan Piplai and Niloy Majumdar have indicated that the cost of supplies under foreign aid has been substantially higher than the prices prevailing for the normal commercial supplies. They have quoted Dr Mehboob Al Haq, a member of the Pakistan Planning Commission who has estimated that the cost of implementing 20 development projects financed by six countries increased by 51 per cent over what it would have been possible from the lowest source of supply. Similarly, Michael Kidron has estimated that India may normally be paying anything between 6 and 15 per cent, sometimes as much as 20-30 per cent above the ruling prices for aid-supported imports. These are suggestive of the fact that the external aid is not all philanthropy; care seems to have been taken by the donor countries to secure the "pound of their flesh."

Impact of Foreign Aid

It is difficult to segregate the impact of external aid on different sectors of the economy. The effect of foreign aid, nonetheless, has been evident in many directions. Once the external assistance begins to flow in, various adjustments become necessary. Sometimes, the administrative machinery has to be reorganized, at times, new fiscal and monetary measures have to be adopted and on other occasions, foreign trade organizations have to be modified to suit the changing conditions. When the technical experts and advisers arrive in a country, many types of sociological adjustments become necessary in order to include and accept them in the social fabric. In this way, several changes occur as a result of foreign aid, many of which are difficult to be identified and categorized. Here, we shall however mention the impact of foreign aid on agriculture, industrial development, foreign trade, debt servicing liabilities, and on inflationary monetary expansion.

Impact on Agriculture

Any proper assessment of the impact of foreign aid on agricultural sector should also take into account the assistance given for those sectors of industrial development which help agriculture. Various items of manufacture such as agricultural implements, tractors and parts, diesel pump as well as fertilizers and pesticides have significant impact on augmenting the productivity of land. Educational research and training facilities relating to agricultural subjects are also relevant in the present context. Agricultural demonstration farms, supply of dairy equipment, leather tanning equipment and many other similar items which influence the agricultural activities should also be taken into account. Necessarily, they involve complicated estimates.

Even a limited approach to such estimation would indicate that the proportion of foreign aid directed to agricultural

development has been declining, nonetheless, its contribution has been significant. According to Professor V.K.R.V. Rao and Dr Dharm Narain, the total authorization for the agricultural sector including commodity imports amounted to 43 per cent during the First Plan period, and 65 per cent during the Second Plan period. Of these, the commodity imports accounted for 29 per cent during the First Plan period, and 64.6 per cent during the Second Plan period. For the Third Plan, the total authorization for agricultural development has been estimated at only 12.7 per cent; 12 per cent of which might have been in the form of commodity imports. An estimate made of purpose-wise distribution of total external assistance authorized up to 31 March 1955 has put 30.9 per cent of the total aid as on agricultural development, this is besides 6.8 per cent of the total on irrigation and power projects.

Impact on Industrial Development

Of the total authorization of external aid to India, almost half of it has been intended for industrial development. The impact of foreign aid on this sector has indeed been substantial. The changing spectrum of industrial expansion in India has primarily been the outcome of external aid.

At the outset, however, mention may be made of the setting up of the three steel plants at Bhilai (with Soviet aid), Rourkela (with West German aid) and Durgapur (with the UK assistance) of one million ton ingot capacity each in the public sector, and the modernization and expansion of TISCO and IISCO in the private sector which have added a further 1.5 million tons of steel capacity. There have been many other projects such as drug projects at Santnagar (A.P.), Rishikesh (U.P.), Munnar (Kerala) and Guindy (Madras), Heavy Machine Tools (Ranchi), Heavy Electricals (Bhopal), and other similar projects which have been vital for providing extensive base for further development of the related industries and have been implemented with assistance from

various advanced countries.

Impact on Foreign Trade

Even the pattern and the direction of foreign trade have very much altered as a result of external aid. The Indian trade with the East European Socialist countries has very much increased as a result of Rupee Payment agreements. Under these agreements, India received external aid from these countries against rupee payments. This reduces the foreign exchange strain on India. Under this arrangement, the payments are made in Indian merchandise and exported to the donor countries. This has opened new sources for the supply of foreign aid to India, and it has also established new markets for the Indian merchandise. Similarly, India has entered into agreement with Japan under which India supplies to Japan iron ores against external aid supplied by the latter. This has expanded India's export opportunities in the Japanese market. It is interesting to observe the diversion taking place in Indian foreign trade from the West European countries to the Socialist countries. The Indian trade with the United Kingdom in particular and the Commonwealth countries in general has also been declining. Such changes are vital. A critical appraisal of the long-term repercussions of the diversion from democratic to Socialist countries should be made at an early date in order to finalize the best course for the country.

Here, another point which has already been made earlier, relating to the aid supported imports and repayment in exports, may be referred to in the present context. In the long-term, high-cost imports cannot endure when the flow of external aid would cease. Similarly, the unnatural exports under temporary stimulus would have to adjust to natural conditions. Thus external aid might be considered leading the pattern and direction of trade in the aided country to an unnatural temporary balancing.

Debt Servicing Liability

There are two kinds of repayments involved in debt servic-

ing liabilities. These are amortizations and interest payments. The former refers to the repayments of capital, that is, the amount paid to the donor *in order to extinguish* the debt liability, and the latter to the amount paid *for the use* of money lent. The level of debt servicing liability in any year would depend upon the quantum of loan element of the external aid and the structure of interest rates for those loans. The following table shows India's debt servicing liabilities for the last few years.

TABLE 3
TOTAL DEBT SERVICING LIABILITY
(MILLION DOLLAR EQUIVALENT)

<i>Year</i>	<i>Amortization</i>	<i>Interest</i>	<i>Total</i>
1960-61		-	115
1961-62	145	69	214
1962-63	105	81	186
1963-64	124	100	224
1964-65	147	107	254
1965-66	124	139	263
1966-67	184	135	319
1967-68	283	161	444
1968-69	—	—	517

SOURCE : *Economic Survey, 1968-69*, Ministry of Finance, New Delhi.

The total debt servicing liability of India has increased from \$ 115 million in 1960-61 amounting to 8.3 per cent of her exports in that year to \$ 444 million in 1967-68 which is of the order of 27.8 per cent of the exports. In 1968-69, the debt servicing liability would amount to about \$ 517 million. As it would be seen from the above table, the total debt service charges have been rising sharply since 1965-66. This considerably reduces the net worth of the foreign aid received. The need for debt rescheduling, therefore, becomes of urgent importance. Otherwise, such a high level of foreign exchange commitment would substantially corrode the advantage of exports. *Economic Survey, 1967-68*, has appropriately emphasized the point. It has stated:

In 1966-67, debt service payments were large and represented a substantial increase over the preceding year. During the current year, debt service payments have gone up further and there was the additional burden of financing food imports. Foreign exchange required for these two purposes constituted nearly 40 per cent of the total free foreign exchange expenditure on imports and debt service and nearly 50 per cent of the country's foreign exchange earnings from exports. In absence of freely usable assistance in adequate amounts, a considerable part of the inescapable imports and debt service payments had to be financed by running down foreign exchange reserves -

The above indicates the long-term difficulties created by foreign aid. Greater the debt servicing liability, heavier the foreign exchange burden and more severe the limitations imposed on the economy. Indiscriminate acceptance of foreign aid in some cases might even stagger the economy to such an extent that self-reliance would remain merely a pious hope.

Aid Under Public Law 480

Assessment of the impact of commodity aid under Public Law 480 has been controversial. The payments for the commodities imported under this programme mostly made in Indian currency are deposited with the Reserve Bank of India since 1960, instead of with State Bank of India as during the earlier period. The amount is deposited in the US Embassy account on which it earns interest as well. Subject to marginal adjustments, 40 per cent of the accruals are given as loans and 40 per cent as grants to mutually agreed development projects in India. Rest of the amount can be spent by the US Embassy, but it has been stipulated that a portion of it can be given as aid to associates of the American firms, and another portion, on other items of expenditure as agreed under Cooley Amendment. It has often been stated that P L 480 aid has

not been helpful to India; and that the Americans under this programme have been dumping in India their own surplus farm products.

Whatever the other consequences, at the very outset, it must be acknowledged that the country would have faced very difficult times fighting famines and droughts if timely foodgrains under this programme did not arrive in India. P.L. 480 aid has also helped the country in fighting the menace of inflation. If the foodgrains were not available, the scarcity would have intensified, the prices would have risen higher and the inflationary spiral would have risen higher still. Furthermore, it should be remembered that many countries have been opposed to the US offer of assistance under this programme. In order to appease such oppositions, it was made a precondition that P.L. 480 imports were not to disrupt the normal international marketing arrangements. Nonetheless, many countries have protested against P.L. 480 aid. They have stated that this programme has unduly depressed the market prospects for many of their commodities. For example, Pakistan has been complaining that the American shipments of P.L. 480 cotton have resulted in lowering the Pakistani earnings from her cotton exports. Greece and Turkey have felt the same with regard to tobacco. The export of wheat under the programme is considered harmful to the exports of Canada and Australia. In this way, it may be shown that no act of kindness can be neutral. Even those who consume P.L. 480 wheat or use P.L. 480 cotton complain of the poor quality of the products. They overlook the fact that the supplies under this Public Law are procured by the recipient government officials, shipment and storage arrangements are made by them, and the products are ultimately distributed to the final consumers by the local administration: the United States Government authorizes the amount to the recipient government in US dollars for direct procurement of the commodities from the US producers. The quality of the supply, in this case, does not depend

upon the donor country, rather it depends upon the procuring agencies.

A serious complaint against P. L. 480 programme has been connected with its repercussion on the monetary expansion of the recipient country. Eminent economists had taken positions on opposing sides. Therefore, the Estimates Committee of the Lok Sabha recommended that this matter should be carefully looked into. In accordance with this recommendation, the Ministry of Finance of the Government of India set up in June 1968 a group headed by A.M. Khusro, Professor of Monetary Economics, University of Delhi, to study the impact of the P.L. 480 transactions on the Indian monetary system and to suggest means to overcome the difficulties. The Group has expressed the view that the transactions have resulted in providing budgetary support to the government to the extent of the value of foodgrains imported under the agreement minus the amount actually spent by the US authorities either for their own use or for giving loans to the private sector under the Cooley Fund programme. The Group has, therefore, opined that the net effect is that to the extent the transactions provided resources to the government, they reduced its deficit provided other things were equal and as such this part of P.L. 480 assistance has a contractionary effect on the money supply.

At the time of the study of the problem, the Group found that the total amount covered by ten P. L. 480 agreements signed since 1956 was Rs 2,240 crores for the import of agricultural commodities. The US withdrawals had been relatively small averaging out to less than Rs 15 crores per annum, and running in recent years at an annual rate of about Rs 50 crores. This worked around one per cent of the total expenditure in the Union Budget. In the opinion of the Group the budget can easily take care of these withdrawals so long as they continue to be small and spread out over a period of time. Thus, it has been suggested that P.L. 480 transactions do not control the money supply in the country.

The Group has further stated that the change made in 1960

whereby the Reserve Bank of India instead of the State Bank of India acquired P. L. 480 deposits and invested them in government securities was favourable in many ways and it avoided any possible effect on the expansion of monetary supply. So long as P. L. 480 deposits were lodged with the State Bank of India, a rise in its liquidity ratio had an obvious potential for monetary expansion; but the possibility of such an inflationary occurrence has been eliminated after the change in 1960. Even when the deposits were with the State Bank of India, the Khusro Group of experts felt that the potential was not appreciably utilized for monetary expansion.

The P. L. 480 fund has, however, much inflationary potential specially in future when the flow of commodity imports under the programme begins to dwindle or come to an end. The Group has pointed out that the imports under P. L. 480 programme are not likely to continue for long. Gradually the level of food-grains imported under this programme would decline. This need not be accompanied by simultaneous reduction in the fund and the withdrawals by the Embassy of the United States. If during any period, the US withdrawals exceed the value of fresh imports, the P. L. 480 transactions might be inflationary. But, in that case also, this would be reflected in the budgetary deficits of the Union Government. When this happens, there is adequate machinery at the disposal of the government to counteract such a deficit through taxation and other measures. However, the Group has concluded that a major source of inflation lies in the final accumulation of fund in the US hands in India. As the projects under P.L. 480 agreements mature and repayment of capital with 4 per cent interest is made by the Government of India into the American account at the Reserve Bank of India, a large volume of liquidity would pile up in the US hands. Assuming that grain imports are stopped at some date in the future, the re-spending of these accumulated funds by the United States, if allowed freely, can become an obvious source of inflation. The situation, therefore, according to the Group needs serious consideration in order to

ward off such eventualities.

The actual situation that would prevail in future would very much decide the actual repercussions of the heavy US spending out of the P.L. 480 fund. If by the time inflationary impact developed, the Indian economy became a scene of the agricultural revolution and the pace of industrialization also caught up, it is likely that the government might even consider presenting a surplus budget or smaller deficits (than would otherwise be the case) in order to nullify the impact of expenditure on US usage out of accumulated US owned funds in India. Thus, any scheme suggested for counteracting the future course of events following the US spending out of the P.L. 480 fund would depend upon what course the Indian economy itself takes. Nonetheless, the Group has suggested that there could be a cushion to the economy from this kind of inflationary impact if the government could obtain a grant from the United States or, alternatively, enter into a mutual agreement to freeze the fund permanently. In that case, the accumulated amounts or agreed parts thereof can be annihilated and the economy cushioned from their impact. The matter would be akin to the burning of currency notes at retirement, the Group has stated.

The various recommendations of the Group have been considered by the Government of India. It has been stated that the government is alive to the problem. The existing checks on the P.L. 480 fund are thought adequate. Even presently, expenditure out of the fund is made in consultation and with the concurrence of the Government of India. As such, it is not justified to believe that "the government has mortgaged India's future to the United States."

Foreign Aid under Fourth Plan

Dependence on foreign aid is programmed to decline during the Fourth Plan; it would then constitute only 8 per cent of the total outlay as against 25 per cent during the Third Plan. At the end of the Fourth Plan period, the net aid to India is

expected to be half of the current level. This is very necessary in order to bring self-reliance in the economy.

Gross external assistance for the Fourth Five Year Plan may amount to Rs 4,030 crores inclusive of Rs 380 crores of food aid under P.L. 480. Of this, the debt repayment liabilities on account of amortization and interest charges excluding repayments due to I.M.F. amounting to Rs 280 crores would be of the order of Rs 2,280 crores. On an annual average, the debt servicing charges would take away Rs 456 crores and thereby seriously reducing the possibility of earning adequate free foreign exchange. The net foreign aid for the Fourth Plan would amount to Rs 1,750 crores giving an annual average of Rs 350 crores. This will require the programme of import substitution to be carried out more vigorously.

The estimates of foreign exchange requirements have been made on an assumption of imports to account for only Rs 9,630 crores during the period, and exports to show a seven per cent per annum rate of growth yielding Rs 8,300 crores. Both these assumptions are based on many uncertainties. The objective of self-sufficiency can be achieved only on the success gained in the sphere of international trade. This is related to an appropriate programme of import substitution buttressed by vigorous industrial expansion and technological researches. This also requires aggressive export promotion measures which depend on sound domestic economic situation and helpful trend in international relationships. Foreign aid has indeed become an essential ingredient of Indian planning strategy but success in reducing dependence on it would depend on a delicate balancing of many complicated forces.

CHAPTER XI

PLANNING

PLANNING as a strategy for economic development aims at regulating its course and accelerating its tempo. As such, it is related to the task of creating a better society and producing happier individuals. These are laudable social goals. But, in the process of objectification of these aspirations serious complications arise. Instead of working for the good of the people and for the betterment of the society, it so happens, many a time unintentionally, that the society is put on the road to serfdom. This possibility is further enhanced if the vast population, as is generally the case in underdeveloped countries, is not well educated and appropriately informed. Unless the society is adequately prepared, the use of planning technique for regulating and accelerating the tempo of its growth might do more harm than good. Planning in a suitable *milieu* might be an effective instrument of social engineering; if properly exercised it might create a better society, but wielded ineptly, it might force the masses to lasting servitude. The danger in planning arises from an inordinate emphasis on predetermined rigid targets and on activating the economic forces towards achieving them without recognizing the limitations of planning and its explosive possibilities.

Planning involves decision-making functions. Goals of planning are set out deliberately. This is done on the assumption that the society left to itself could not attain the best conditions for its growth. Therefore, the economic forces have to be regulated and activated. This leads to polarization between decision-making authority and decision-implementing individuals. The planning authority makes the decisions and the people carry them out. This polarization breeds trouble. Even under monarchy with kings having divine right to the State, it is not necessary that there should be chaos and poverty. Many ancient States under able and benevolent rulers have been

materially prosperous. But, this did not satisfy the people. The main difficulty arose due to the separation between the decision-making authority and the decision-implementing individuals. Under this situation, the individuals did not enjoy freedom; therefore, it was to be avoided.

Many philosophers have recognized this anomaly. That was the beginning of the socialist uprisings. Shortly before Adam Smith's inquiry into the wealth of nations, Jean-Jacques Rousseau was engaged in analyzing the ultimate basis of governmental authority as it influenced human welfare. His magnum opus *Le Contrat Social*, Rousseau began by emphasizing that all men are born free but everywhere they are in fetters. Emphasizing the need for emancipating individuals from social orthodoxy and institutional rigidities, Rousseau enunciated his principles of governmental authority and human conduct which ultimately resulted in the French Revolution and overthrow of the monarchy. It was indeed a fight between the decision-making authority and the decision-implementing individuals. The individuals triumphed in this struggle but they could not maintain their freedom for a long time. There have been struggles for power and survival even after this period. As a result of this struggle, the aggressive ones have once again subjugated the meek and the docile. As a result of this tendency, the spirit of liberty, fraternity, and equality has again died out. Sloth and inertia of human temperament have made it possible for a handful of individuals to subjugate the mind and the life of the multitude. The aggressive ones have again triumphed in the struggle for survival and for power. The spirit of Rousseau is dead, though the carcass still survives!

This struggle for survival has been so profound and so pervasive that it has dived deep even in the human psyche wherefrom it captivates the unwary in many surreptitious ways. At present, the problem is not merely of physical survival; individuals have so much identified themselves with their ideologies, groups, parties, and leaders that the subjugation and conversion of others to one's own ways of thinking and living have been

more vital to them than their physical survival. This struggle between different individuals prevails in every sphere of human activities. It can be observed even in planning strategy.

Planning being necessarily a matter of value decisions about social goals depending upon the background of the individuals who decide the affairs of the State would necessarily depend on their (psychological) conditionings and on their personal and social backgrounds. The inherent danger in planning arises from the fact that the decisions are taken by a group of people on vital matters affecting the destinies of the rest of the community. In this sense, the planning process becomes an attempt to universalize the desires of a few individuals.

Under dictatorship, it would be the desire or ambition of a single individual. Under communism, it would be the desire of those individuals who conform to the communistic faith. Under democracy, the individuals who manage to align themselves with a large number of individuals impose their desires on the community. Under no system of government there is adequate protection for the meek and independently thinking individuals. Thomas Hobbes in this situation, if reincarnating again would have to fundamentally alter his assumptions regarding the basic human nature, and therefore, his justification for the origin of the State. Furthermore, those who are in power are not always capable of having expert knowledge of every problem under deliberation.

In-built Difficulties

Almost every government of the modern age considers regulation of economic forces as its primary responsibility. The US Government championing the cause of personal freedom decides many vital issues relating to monetary and currency policies, industrial licensing, and distribution of industrial inputs and final consumption items. The Union of the Soviet Socialist Republics controls almost every aspect of human activities. Almost all forms of commercial and economic transactions are controlled by the Soviet Union. In between these two extremes, there

are varying degrees of controls. When such regulations are purposive and directed towards achieving a predetermined target, they become parts of the planning strategy.

“ Thus, basically, planning is of two varieties: one in which all forms of business activities are controlled physically and rigidly. In the other category, the economic forces, mainly of the fiscal nature, are adjusted in such a manner as to attain the desired objective. When the planning authority merely sets out the goal and stresses the desirability of the same without rigidly adhering to the predetermined target or without arranging for the adequate resources necessary for achieving the targets the process may be known as “indicative planning.” The different kinds of input-output tables or the shadow pricing systems are merely different devices for obtaining appropriate data for making necessary decisions. They may, therefore, be considered merely as planning tools.

An essential step in planning is to take decisions relating to targets and priorities. If the planning authority has the responsibility for determining the various goals of economic action, such decisions might begin a series of chain-reactions which might, in the long-term, even disrupt the economy. The separation of powers between judiciary, legislature, and executive wings of the State is considered essential for maintaining democracy; in the sphere of economic activities, the concentration of decision-making functions, risk bearing responsibility and the right to enjoy the fruits of one's labour is essential. It is for this characteristic pertaining to concentration of various aspects of economic functions that planning introduces an element of arbitrariness. This very characteristic breeds explosive situation. The separation of economic functions leading to inner contradictions in the system might bring about stagnation instead of progress.

Decision under democratic planning for establishing different projects is taken by the legislature; the implementation of the programme is carried out by the civil servants (even the workers in public undertakings may be considered as civil

servants); the financial resources for the projects are supplied by the tax-payers; and prices of the products are fixed according to the conveniences of the consumers mainly on political considerations. This kind of separation of functions is not helpful in the economic sphere. Under this situation, no one is willing to take calculated risks. Those who take decisions in this setup do not have to pay for the losses occurring due to their wrong decisions. The civil servants being responsible to departmental enquiries and Accounts Committees for their actions leading to financial failures cannot be bold enough to take financial risks. There is no reward for outstanding individuals with initiative and specialized abilities. This system is unresponsive to quick financial decisions necessary for business and commercial success.

Such difficulties are very much accentuated in a mixed economy with a predominant private sector. Private initiative is based on profit motive. It cannot successfully work in a society cluttered with excessive regulations, uncertainties and inadequate supply of essential industrial inputs. When the private sector is unable to take its investment decisions and when there is danger of profit being appropriated in one way or another, it would be futile to expect the private sector to deliver the goods. In a mixed economy, the private sector is necessarily put at discount.

Moreover, as long as the decisions regarding the development of various industries are taken by the planning authority with no uncertainty and no risk involved as in private initiative, the new experimental enterprises which have greater possibility for not succeeding would not be forthcoming. Assured profitability and lack of competition are the most important inducements for inefficiency in the private sector. Such stipulations being inherent in the planning process, they generally destroy the inherent vitality and urge for innovations and experimentation in the private sector.

The question of social justice is an important consideration for according great significance to planning. Concentration of

economic (as well as political) power, price regulation, distribution of essential supplies, reduction of regional imbalance, unemployment and several other problems of great social consequences are expected to be tackled through the planning machinery. But there is no short-cut for providing social justice. In order to tackle these problems effectively, one will have to see clearly that physical planning under a democratic setup is no solution to these problems. It is extremely difficult to examine and accept the futility of planning in this sense. Some of the contradictions of planning are coming to light, but it may take a few decades more to realize the inner contradictions of "Statism." Only after such a realization, a radically different type of planning may be attempted.

The Drama of Development

During the last two centuries, especially since the publication of *An Inquiry into the Nature and Causes of the Wealth of Nations* by Adam Smith, the task of social engineering has been a baffling one. By his latest book, *Asian Drama: An Inquiry into the Poverty of Nations*, Gunnar Myrdal has further emphasized the complexity of the situation. There have been many difficulties in this regard. Almost every industrialized country has been willing and endeavouring to assist the development of the backward countries, nonetheless, the rate of progress has so far been depressing. A sense of mutual disenchantment has developed among the aid-giving and the aid-receiving countries. It has been recognized that the provision of external assistance does not hold a magic wand. But then, what does hold the magic cure?

Gunnar Myrdal has emphasized that "the problems of under-development, development, and planning for development in South Asia are themselves exceedingly difficult and that they have yet to be mastered."¹ Commenting on the thesis of Myrdal, Director of the Economic Development Institute, Dr K. S.

¹Gunnar Myrdal, *Asian Drama: An Inquiry into the Poverty of Nations*, New York, p. 28.

Krishnaswamy has rightly observed:

Myrdal holds that development is not a mechanical process of adding to capital stock, human skills, technological knowledge and artifices but a matter of institutional change, of attitudes and behaviour pattern of all those intangible elements that distinguish a human society from a field of particles or a colony of ants. Changes in these intangibles can be brought about by an understanding of the springs of human action in the less developed countries.²

Understanding the springs of human action is a difficult phenomenon; it is easier to supply colossal foreign aid and technical know-how than investigating into the motivating factors of social action and directing them to any purposive goal. It is here that the drama of economic development shifts from physical to psychological locale.

As the movement of the whole system upwards, according to Myrdal, is what is meant by development, it becomes the primary responsibility of the government both to decide on what needs to be done, and to get, by persuasion or by compulsion, adequate support for the chosen course of action.³ In order to do so, the prevailing undesirable attitudes and institutions have to be changed in a desirable direction. But the vital question remains to be answered. Who is to do this ordering, the government, the elite, the masses, the urban community, the young or the old? This is indeed a complex issue. Dr Krishnaswamy has rightly suggested the urgency of much research and experimentations in order to fill the gaps in the knowledge of developmental process. According to him, probably "a new body of knowledge and a new type of social scientists" would be required for the purpose. Evidently, therefore, the deep concern at the growing gap between aspirations and achievements in the

²K. S. Krishnaswamy, "Some Thoughts on a Drama," *Finance and Development*, Washington, Vol. I, 1969, p. 45.

³*Ibid.*, p. 48.

developing world cannot be ameliorated by any planning strategy so far evolved.

Indian Planning Experience

The Government of India has faith in planning. Ever since independence, and even from earlier times, the question of planning has been under consideration by various groups and organizations. Recognizing the necessity for planning in order to strengthen the economy, the Government of India set up the Planning Commission in March 1950, *inter alia*, to formulate plans for the most effective and balanced utilization of the country's resources. In this way, the urge for planning has been given a concrete shape. With the formulation of the First Five Year Plan, about decade and a half ago, the process of planned economic development began in the country.

The primary objective of the First Five Year Plan as well as of the successive ones has been to raise the living standard of the people and to open up to them new opportunities for a richer and a more varied life. The First Plan also sought to rehabilitate the economy from the damages done during the earlier period. War, famines, and partition had seriously disrupted the economic life of the country. The First Plan aimed at remedying the evil influences of these forces. It also tried to formulate policies and to build up institutions helpful for developing the economy in the desired direction.

The Second Five Year Plan carried the process further, accelerated the rate of growth and initiated a strategy of development introducing structural changes necessary for long-term economic strength of the country. The Third Five Year Plan raised the sights and set the achievement of a "good life" for every citizen as the ultimate goal of socialist society that the country had already accepted. As a result of the three five-yearly plans, the country has achieved substantial success. But much still remains to be done. It would be difficult to accept that the goal of a good life has been achieved. Probably it would take a much longer period in concretizing

the concept of a good life and achieving it.

Pointers of Progress

In statistical terms, however, India's national income in real terms increased by 81.5 per cent between 1951-52 and 1967-68. Meanwhile, population increased by 41.8 per cent. The increase in per capita income was therefore of the order of 26 per cent. Although this attainment is not satisfactory from the point of view of its impact on the living standard of the average citizen or in terms of the requirements of the take-off yet it is significant both in relation to past performance and to the relative record in most of the less developed countries of the world.

Even in the agricultural sector, the absolute increase in production has been large. The index of agricultural production went up from a level of 96 in 1950-51 (related to 100 in 1949-50) to 158.5 in 1964-65 showing an increase of about 65 per cent in 14 years. The subsequent years witnessed a precipitous fall of production on account of unprecedented drought showing a fall by nearly 20 per cent in the foodgrains production in 1965-66. The index of aggregate output was lower by a sixth. The foodgrains output in 1967-68, however, reached 95.6 million tonnes and in 1968-69 it amounted to 98 million tonnes. Agricultural production as a whole has shown an average annual rate of increase of about 2.5 per cent. This may not be a satisfactory or sufficient level of production, but it does indicate a sizeable advance.

Industrial production is now about three times as large as at the commencement of the First Plan. The average annual rate of increase was 5 per cent in the First Plan, 6 per cent in the Second Plan, and 6.6 per cent in the Third Plan. The spectrum of industrial production has greatly diversified. Greater amount of capital goods and many other sophisticated items are being indigenously produced. Rapid progress has been made in the direction of import substitution. The output of capital goods and intermediate products increased by

136 per cent during the period 1955 to 1967 while the total industrial output rose by 113 per cent only. This indicates the progressively rising share of capital goods and intermediate products in the total industrial output. The ratio of capital goods imports to total imports has also substantially declined. The proportion of raw material imports to value added by industries declined substantially from about 38 per cent in 1950-51 to less than 15 per cent in 1966-67. There has been a setback in industrial development in recent years but the events have begun taking a turn. The Indian industrial structure has now a wide base and is well differentiated.

In the field of social services, education has expanded rapidly. Literacy as a whole has gone up from 16.6 per cent in 1951 to 24 per cent in 1961 and is probably around 35 to 40 per cent currently. The number of children in primary schools has gone up from 22 million in 1950-51 to 69 million in 1968-69. At the secondary stage, the children receiving education now number 7 million as compared to 1 million in 1950-51. There are now 70 universities in India as compared to some 20 two decades ago and the student population in schools, colleges, and universities totals 78 million as compared to 23 million in 1950-51. India is still far from the goal of universal literacy, and there has been discontent about the quality of education, especially at the higher stages. Still what has been achieved is highly impressive.

There is similar progress with health services. The number of doctors is 102 thousand as compared to 56 thousand two decades ago and the number of hospitals has gone up from three thousand to 15 thousand. Though the rural areas are not well served as the urban areas, yet the progress in this regard has been spectacular.

These have been some of the indicators of progress during the last 18 years or so. Recently, however, the Indian planning has got into difficulties. There have been several causes for the same. The heavy burden of defence outlay caused by the aggressive posture of China and Pakistan, food famines caused

by droughts and floods, drying up of foreign assistance, and growing disenchantment with planning machinery have been some of the factors in this regard. The Planning Commission has also lost its prestigious position. A new set of members of the Commission had to be appointed and the method of its working had to be reorganized. The formulation of the Fourth Five Year Plan was postponed by three years. The Fourth Five Year Plan beginning with April 1969 has now been formulated under a radically different set of conditions. But the final shape of the Fourth Plan is yet to be decided.

Approach to the Fourth Plan

The Fourth Five Year Plan aims at changing the traditional pattern of economic development and introducing a more effective technique to create a vigorous and enthusiastic society. Soon after assuming the Deputy Chairmanship of the Planning Commission, at a time when the *Draft Outline* of the Fourth Plan was already published, Professor D.R. Gadgil announced his determination to pursue the goal of social reconstruction on a line very much different from the old one. He indicated on that occasion that he intended to promote a re-examination of the basic aims of planning and methods to rescue the reputation of Indian planning which had been badly damaged at home and abroad by the failures of the Third and the Fourth Plans.⁴ As a result of this announcement, the proposals and programmes incorporated in the *Draft Outline* lost their validity.

The new plan had to be different from the earlier ones. This could not, however, be drawn on an entirely new foundation. The new plan had to take into account the progress so far achieved, economic forces already generated, social and economic organizations established and the hopes and aspirations aroused among the people. The Fourth Five Year Plan was therefore expected to be a link between the old and the

⁴Arthagnani, "Future of the Planning Commission," *Development Digest*, Washington, Vol. VI, No. 1, January 1968.

new; but its success or failures would depend upon its ability in giving a new direction to national planning, not in continuation of the old one with increased momentum.

While reaffirming the objectives of the earlier plans, the *Draft Outline* included such policies and programmes "which would help in the attainment of economic self-reliance with adequate growth rate and accelerate the progress towards a socialist society."⁵ Growth with stability has been considered the main aim of the Fourth Five Year Plan. But, in the final *Draft*, the objective has been further elucidated. It has stated that the "Fourth Plan has to provide the next step forward in attaining accepted aims and objectives of Indian planning."⁶ While elaborating the content of accepted objectives of planning in India, the *Draft* has stated:

Planning in India has . . . to organize the efficient exploitation of the resources of the country, increase production and step up the tempo of economic activity in general and industrial development in particular to the maximum possible extent. The basic goal is a rapid increase in the standard of living of the people, through measures which also promote equality and social justice.⁷

In order to attain these objectives, the Draft of the Fourth Five Year Plan, formulated in 1969, has envisaged a total outlay of Rs 24,398 crores, of which the public sector outlay amounted to Rs 14,398 crores and the investment in the private sector was anticipated to be Rs 10,000 crores. In the public sector Rs 12,252 crores have been provided for investment and Rs 2,146 crores for the current outlay. The total investment for the creation of productive assets aggregates to Rs 22,252 crores. As a result of this order of investment, the public

⁵*Fourth Five Year Plan, A Draft Outline*, Planning Commission, New Delhi, p. 10.

⁶*Fourth Five Year Plan, 1969-74, Draft*, Planning Commission, New Delhi, p. 12.

⁷*Ibid.*, p. 4.

sector is given a predominating scope for its expansion. The proportion of investment expenditure between the public and the private sectors is, however, expected to shift from 3 : 2 during the Third Plan to 1.2 : 1.0 during the Fourth Five Year Plan.

Agricultural Development

The highest priority has been assigned to the agricultural development. Taking into account the likely increases in demand for foodgrains and other related factors, foodgrains production has been programmed to increase from 98 million tonnes in 1968-69 to 129 million tonnes in 1973-74. Sugarcane (gur) is planned to increase from 12 million tonnes to 15 million tonnes, oilseeds from 8.5 million tonnes to 10.5 million tonnes, cotton from 6.0 million bales to 8.0 million bales, and jute from 6.2 million bales to 7.4 million bales. The production of cashew nuts has been scheduled to increase from the present level of 160,000 tonnes in 1968-69 to 236,000 tonnes in 1973-74. It has been estimated that demand for agricultural products will grow at the rate of 4.5 per cent per annum in the Fourth Plan. The target for growth of agricultural production has, however, been fixed at 5 per cent per annum in the Fourth Plan. It has been done so in order to eliminate the need for imports of foodgrains after 1970-71. During the Fourth Plan, efforts will also be made to eliminate violent fluctuations in the annual rates of agricultural production.

Industrial Development

In order to achieve agricultural targets and to activate the agricultural sector, even the tempo of industrialization has to increase and the structure of industrial production has to be modified. The question of import substitution would remain paramount during the next five years. The pattern of industrial development over the next decade or so is expected to be modified by the necessity of meeting the indigenous requirements by domestic production of a wide range of manufactures which admit of economic production. The Fourth Five Year Plan has

envisaged that the steel capacity would be stepped up from the level of approximately 9 million tonnes in 1968-69 to about 12 million tonnes of ingots by 1973-74. Significant increases in the domestic production of aluminium and substantial additions to copper and zinc would occur in the category of non-ferrous metals. The production of aluminium would be stepped up from about 120,000 tonnes in 1968-69 to 220,000 tonnes in 1973-74.

The Fourth Plan has programmed substantial expansion in the domestic production of different types of fertilizers. They have been considered essential in order to reach the targets set for agricultural production. Three million tonnes of nitrogenous fertilizers are expected to be produced by the end of the Fourth Plan period. A provision of Rs 262 crores has been made in the public sector for establishing new fertilizer plants.

Among the petro-chemical group of industries, it is envisaged that the production carried out with regard to aromatics projects and naphtha cracker project at Koyali in the public sector would make a substantial progress in meeting the requirements of intermediates for the production of synthetic fibres and synthetic rubber. They would also add to the capacity of plastics. An important development in the private sector is the establishment of a caprolactum project by the Gujarat Fertilizers. These developments are expected to make a considerable impact on import substitution. It would also assist further development of the dye-stuffs industry.

The refinery capacity in terms of crude throughput and production during 1968-69 were 17.5 and 16.1 million tonnes respectively. The demand for petroleum products is expected to increase to around 26 million tonnes by 1973-74. The additional requirements are at present proposed to be met from the expansion of the refineries. The plan makes provision for the expansion of the refineries in the public sector.

Similar expansion and diversification programmes in other sectors have also been incorporated. As a result of these schemes, it is expected that industrial production during the

next five years would show an average annual increase of 8 to 10 per cent.

Social Justice and Equality

The objective of Indian planning is not merely to increase national income and to raise the per capita income but also to ensure that the benefit is evenly distributed, that disparities in income and living are not widened but in fact narrowed, and that the progress of economic development does not lead to social tensions endangering the fabric of the democratic society. The aim of providing social justice to the people could be difficult without any positive intervention by the State. There are many advantages which can be easily made available to the backward areas and to the handicapped sections of the population with the assistance of government. The Fourth Five Year Plan has enumerated (a) greater concentration of wealth and income, (b) overgrowth of metropolitan centres and uneven regional development, and (c) technological unemployment and rural underemployment as the important maladies which should be avoided as far as possible.

The problem of imbalance in development of different States is highly complex. During the course of the last three plans, much has been done to reduce the disparities between different regions. Apart from giving financial assistance in order to attract new industrialists to less developed regions, the licensing of industrial units, setting up of rural industries projects, establishing large public projects, developing small industries sector, and assisting industrial estates have been programmed with a view to creating better balance between different regions and for bringing about better dispersal of industries. But the results so far achieved have not been encouraging.

The Fourth Plan lays down that the differences in development between different States arise out of variations in activity in the three sectors, namely, cooperative, private, and public. Development of the cooperative sector is related to the strength and coverage of cooperatives in the State. The most important

drawback in this regard has been the paucity of funds; the organizational weaknesses have been another retarding factor. The private sector activity is primarily related to the entrepreneurship available in the State. The financial assistance and infrastructure available in the various States have also substantial effect. Only on the availability of such resources would depend the attraction for the industrialists from other States. And even the public sector cannot do much if the resources in the State are very much lacking. In order to support the financial assistance available in the State, the Fourth Plan has evolved some formula giving weightage to the backwardness of the State in according central assistance. It is hoped that this might be of some help to the underdeveloped States.

Organizational Adjustments

Many adjustments are required in order to ensure that the course of the development would be smooth. Implementation of the programmes incorporated in the Fourth Plan would demand setting up of many new agencies and reorganization of the several existing ones. Here, we shall draw attention to two important adjustments in the present context.

Administrative Reorganization

Effective implementation of the plan of such a colossal size would certainly devolve substantial responsibility to the administrative machinery. An organization primarily concerned with maintaining law and order has to be fundamentally different from that charged with the responsibility of economic administration. Recognizing this situation the *Draft Outline* had emphasized the fact that the administrative machinery and procedures as well as managerial functions at all levels had to be geared up to the basic economic and social tasks which would help the country to tide over the present difficulties and achieve the objectives which it had set before itself. While elaborating the need for administrative reorganization, the *Draft Outline* has recorded as follows:

In each of the Five Year Plans, there has been a significant

gap between planning and implementation. The burdens thrown upon the political system and the administrative structure have increased steadily. Although many innovations have been made and much has been done to strengthen administrative and technical agencies and build up trained personnel, both at the Centre and in the States, a great variety of tasks, old and new, have fallen in the main upon the same institutions, namely, ministers, Secretariat departments, executive agencies, and the collectors and other district officials. With increase in the size and scope of development programmes, the volume of work has grown considerably. Current problems such as rise in prices or shortages in essential commodities have also added greatly to the strains under which the administrative machinery functions. . . . The ground for a concerted drive for better implementation of plans has been prepared. When the recommendations of the Administrative Reforms Commission, which is engaged in a comprehensive study of all aspects of administrative reforms become available, it should be possible to go beyond the immediate tasks and to consider more basic changes in the structure and functions of the administrative system as a whole.⁸

The *Fourth Five Year Plan (1969-74) Draft* has also stressed the importance of efficient administrative machinery for the effective implementation of the Plan. It has recognized the urgency of the problem but as the Administrative Reforms Commission has to make detailed recommendations with regard to this problem, the *Draft* has refrained from making detailed observations. It has, however, stated:

Implementation of plans is intimately associated with better organization and operation of the general administrative machinery. . . . The structure of the older organization and its line of command were inevitably constructed round

⁸*Fourth Five Year Plan, A Draft Outline*, pp. 154-5.

the generalist administrator. This has to undergo modification in that the specialist, the technician, and the expert have to be enabled to make their contribution in a responsible manner at all levels of administration.⁹

From the above it may be observed that the administrative tasks involved in successful implementation of the plans have been well recognized. As this aspect of planning is also important, it is expected that it would be soon streamlined and effective procedures adopted for the specialized work in hand.

Modifications in Industrial Licensing

The Fourth Plan departs from the earlier ones in stating clearly the policy with regard to industrial licensing and economic controls. Recognizing the two fundamental constraints on the Indian economy, namely, the scarcity of foreign exchanges and the urgency of avoiding economic concentration of power and regional disparities of income, the Fourth Plan has proposed liberalization with regard to industrial licensing. Whenever the proposal for setting up a unit has significant foreign exchange component either by way of capital importation or by way of maintenance imports, the application has to be considered carefully from the foreign exchange standpoint, otherwise the element of liberalization should be gradually introduced. The Fourth Plan Draft has suggested that

- (1) all basic and strategic industries, involving significant investments of foreign exchange should be carefully planned and subjected to industrial licensing. It is necessary to ensure effective performance and to keep a close watch on the development of these industries. Hence, once the licence is granted, credit, foreign exchange, and scarce raw materials would be earmarked for them, and made available in time. This should be done for units

⁹*Fourth Five Year Plan, 1969-74, Draft, p. 104.*

both in the public and the private sectors;

(2) industries requiring only marginal assistance by way of foreign exchange for capital equipment may be exempted from the need to secure industrial licences. For this purpose, the foreign exchange ceiling may be stipulated at about 10 per cent of the total value of the capital equipment. The release of foreign exchange would continue to be regulated and the import of capital goods screened by the Capital Goods Committee. However, in industries in which, though the foreign capital component is low, the maintenance imports component is high, it will be necessary to continue licensing ; and

(3) industries which do not call for foreign exchange for import of capital equipment or raw materials should be exempted from the requirements of industrial licensing. In these industries, there should be freedom for private enterprises to operate in accordance with the market requirements.¹⁰

While taking final decisions for granting licences or exempting any specific industries from the requirements of an industrial licensing, due care will be taken to avoid any of its undesirable consequences. Efforts will be necessary to avoid congestions in metropolitan areas and the demands of different backward regions will also have to be taken into account. But, generally speaking, the Fourth Five Year Plan stipulates greater liberalization in this regard. This policy is expected to accord better opportunities and freedom to the private sector for giving a fillip to the industrial growth of the country.

Special Features of the Fourth Plan

Every plan is related with the earlier ones, but it is also different from the others. This unique relationship exists because some plans are merely horizontal extensions of the

¹⁰*Ibid.*, pp. 238-9.

old edifice providing greater accommodation in the same, whereas others are like a bridge enabling the community to travel to a new economic *milieu*. The Fourth Five Year Plan might prove to be a bridge in this sense. But this would depend upon the implementation of the Plan and fulfilment of the aspirations of the new generation. The Fourth Plan looks to a new direction, unfolds many new dimensions of development, and arouses many new hopes. Success in achieving these goals would depend upon proper stimulus to basic creative urges of the people. It may, however, be difficult if the contemporary frustration in the world in general and India in particular continues to grow.

Foreign Aid Reduction

An important objective of the Fourth Plan is to achieve drastic reduction in foreign aid keeping in view the objective of growth and stability. This pertinent voice of conscience has recently become louder. "A process of development sustained by continuous foreign aid cannot be healthy," the *Approach* document has reported. The aim of the Fourth Plan has been to reduce foreign aid net of interest and loan repayments to about half the present level by the last year of the Fourth Plan. This objective has been reiterated in the *Draft*. It has stated: "Dependence on foreign aid will be greatly reduced in the course of the Fourth Plan. It is planned to do away with P.L. 480 imports at the end of the next two years. Foreign aid net of debt charges and interest payments will be reduced to about half by the end of the Fourth Plan compared to the current level."¹¹ In order to attain this target, imports will have to grow in manageable proportions, and exports will have to grow by about 7 per cent per year. Whether these triple objectives will be achieved or not remains to be seen. They require substantial rate of growth of indigenous industrial and agricultural outputs, growing market opportunities for the expansion of traditional, engineering, and non-

¹¹*Ibid.*, p. 13.

engineering export goods, and favourable monsoons accompanied by domestic and global peace.

Liberalization of Controls

Mention has already been made of liberalization of industrial licensing. Gradually greater freedom will be necessary for encouraging rapid industrial production. At present, various kinds of controls relating to industrial licensing, import restrictions, authorizations of capital goods imports, and distribution of industrial inputs and final products have been operating. These have been necessitated by different kinds of shortages prevailing in the economy. This situation is likely to improve soon. When that happens, the controls would be gradually relaxed. As a matter of fact, a move in this direction has already been made. Many schedule industries have recently been delicensed. The distribution of industrial inputs has also become easy and the level of indigenous production has been rising. When increases in the production of foodgrains, raw materials, and manufactured goods become substantial, they would have salutary impact on Indian imports.

Mixed Economy Strengthened

The private sector has been assigned a substantial role to play during the next five years. It has, however, to function within the regulations intended to ensure the greatest gain for the society. If the public sector has to expand its operations and the private sector has to function within the limited freedom accorded to it, a new set of regulatory practices with adequate freedom for the private sector would be inevitable. The *Draft Outline* has suggested that:

One of the weakest areas in Indian planning is the regulation and direction of the private sector. We need to devise, therefore, a suitable machinery for the progressing and implementation of developmental programmes in the private sector. Non-priority diversions have to be discouraged and priority items have to be adequately serviced and

speeded up in both formulation and execution. Fiscal, administrative and other methods of regulation, inducement, deterrence, vigilance, and evaluation have all to be harnessed for ensuring the fulfilment of plan targets in the private sector.¹²

In view of the fact that the mixed economy is expected to operate in India for some time to come, special efforts have been made to regulate and guide the development of both the sectors. The private and the public sectors must grow in an integrated manner. In order to encourage their growth within the framework of general economic development, the various measures of regulation in this regard have been divided in five main categories such as those relating to (1) prices and allocation, (2) investment outlays and patterns, (3) entry and location, (4) monopoly and concentration, and (5) operation of individual units. The importance of industrial licensing in these regards has been considerable. The monopolies legislation, judiciously used government's power of licensing and allocation, and purposeful policies with regard to public financial institutions and the public control of banking are expected to play a significant role. They are expected to regulate the development of private sector in such a way that a healthy and energetic mixed economy could grow in the country.

Foreign Collaboration

Foreign technical collaboration has helped the country in improving the level of its technology, imparting technical know-how, and in encouraging import substitution. By equity participation, it has also helped creation of capital stocks which otherwise might have been difficult to build. In this process, however, financial burden of the country has also increased. Payments by way of royalties, returns on capital, and repatriation of capital have also to be taken into account for assess-

¹²*Fourth Five Year Plan, A Draft Outline*, pp. 33-4.

ing the burden on the country. Even otherwise, there have been many other considerations. It has been observed that foreign collaboration is mainly obtained by large corporate houses. New vested interests have therefore grown. Besides, many wasteful and non-essential items have been produced under the impact of such collaboration programmes. Realizing the necessity of welcoming and encouraging foreign investment in certain directions but avoiding them in others, the Fourth Five Year Plan aims at regulating the inflow of foreign capital and technical know-how.

No attempt has been made to introduce any material modification in the basic policy in regard to foreign collaboration. In detailed application of this policy, however, the Fourth Plan would like to ensure that foreign collaboration is resorted to only for meeting a critical gap and that it does not inhibit the maximum utilization of domestic know-how and services. In order to identify the field in which foreign collaboration is required and streamline the procedure for acceptance or otherwise of foreign collaboration proposals, a Foreign Investment Board has been set up. Broad guidelines on which foreign collaboration might be encouraged have been suggested in the Fourth Plan. The *Draft* has stated that foreign collaborations in the production of consumer goods, whether they can be produced within the country or not, will not ordinarily be permitted except in the interest of larger exports. Collaboration in directions in which indigenous effort can within a short time provide the services or goods or a substitute would not be allowed. It is expected to introduce "fairly rigid tests" before such foreign collaboration proposals are approved. Imports of foreign know-how, particularly in sophisticated industrial fields, however, will continue to be permitted. In this sphere also due regard will be given to the programme of completely Indianizing the manufacturing organizations and techniques in a short time.

Reduction of Subsidies

A new shift in emphasis has been made with regard to the provision of subsidies on different items. During the last three plan periods, it has been an acknowledged policy of the government to subsidise various items of consumption as well as various industrial inputs. This is a method of transferring income from one section of population to another. This policy would, as a general rule, be discontinued. The scope of free and subsidised services or supplies given by the State would be strictly limited. General subsidies in relation to agricultural supplies have already been withdrawn to a large extent. During the Fourth Five Year Plan, it is expected that no expenditure will be incurred on food subsidies. The *Draft* has explained the policy by stating that

in a society in which highly unequal distribution of income exists, it is undesirable to make unnecessarily low charges. Above a basic minimum of free service in, say, education and health, appropriate charges have to be levied; these have to be fully economic at the average level and could with the possibility of discrimination be much higher for those with the ability to pay them.¹³

Prospect of Success

Failure of the Fourth Five Year Plan can be predicted only if there is any inherent contradiction in the Plan. This is a technical problem for examination. Implementation of the Plan is another criterion on which the prospect of success can be assessed. If implementation is not satisfactory, the goals would not be attained. There is, however, another consideration. That is, given the reasonable chance of targets being achieved, could it be possible for the Plan to create a better society and to provide a "good life" to the people? Unless the position of the common man is improved, the Plan would be only of a limited significance.

¹³*Fourth Five Year Plan, 1969-74, Draft, p. 19.*

The situation of the common man is not going to improve significantly. There will be gradual reduction of various subsidies that many people used to enjoy. They will now have to work in order to obtain those facilities and privileges. But will this induce the various sections of population to work harder? The general price rise will not be restrained in any effective manner. Unemployment will still remain a drag on the society. Check on favouritism, nepotism, and administrative inefficiency may yet be difficult to apply. Various types of restrictions on economic system would only be gradually withdrawn, but there is no assurance that the alternative situation that would exist in the country would improve the conditions. The grant of consumers' sovereignty essential for the freedom of the common man requires provision of many related conditions. How far these would obtain yet remains to be watched.

Growth and stability requires that the artificial controls and regulations are gradually withdrawn and viable industrial units established. Professor W. Arthur Lewis, one of the world's outstanding authorities on development economics, who has been profoundly connected with economic development of several developing countries, has rightly stressed the limitations of the use of controls and State regulations. He has stated: "For a few years after the Second World War, progressive thinkers, acclaimed rationing and licensing the private sector as inevitable and desirable instruments of economic democracy. But this was only a passing phase. By the middle 1950's all the leading democratic parties in the world had come to realize the licensing as an inefficient and corrupt way of allocating resources, and had dropped it from their programmes."¹⁴ The Fourth Five Year Plan has begun discarding controls and how much of these has been eliminated would be a measure

¹⁴W. Arthur Lewis, *Development Planning, The Essentials of the Economic Policy*, reproduced in *The American Review*, USIS, New Delhi, April 1968, p. 61.

of the progress achieved by the economy on the path of stability and viability.

Success in any social action ultimately depends upon the people who implement the programme and the machinery through which it is implemented. The initiative of the individual has important contribution to make in this regard. In India, there is great importance of this factor. The importance of personal initiative is immense because the country is primarily rural and the rural economy needs a different kind of motivation. The approach to rural development has to be different from that of industrialized urban and metropolitan areas. The Fourth Five Year Plan attempts to reduce regional disparities in development and bring about regional dispersal of industries. A large area of rural sector cannot be completely covered by any comprehensive regulatory device. Private initiative is necessary for the development of rural areas. The rural industrialization does not require only mobilization and regulation of different economic forces, but it also requires mobilization of other basic urges and motivations of the rural people. That can be possible only with a new kind of organization and a different kind of administrative personnel. The failure of cooperatives so far in arousing the enthusiasm of the rural people needs critical scrutiny. In fact, the question of developing the rural areas is a complex one and it has to be tackled with all the vigour at our command.

"Economic growth," as Professor Lewis has rightly indicated, cannot be produced by legislation, administrative regulations or exhortation, without the accompaniment of a high material incentive. Hence the crucial test of the quality of development planning, in that part of the economy which is left to private initiative, is how effective are the incentives offered to the population to make decisions which will result in economic growth."¹⁵ But how can the individual make any decision for the good of the society or for himself if he is obsessed

¹⁵*Ibid.*, p. 66.

with various undesirable psychological entanglements. This, therefore, leads us to a study of basic urges, motivating forces, social integration, and morale building factors in a developing society. In order to succeed in Indian planning with a view to bringing about a new society, it is necessary to arouse new forces and to evolve new values in life. And the greatest of all touchstones is the extent of freedom accorded to the individual in leading a full life. If he has to depend upon State protection for obtaining his basic needs, it would lead to perpetuation of his dependence on a handful of the people who decide the policies of the government. Unless planning aims at creating the conditions where decision-making and decision-implementation could be combined in the single individual or the agency, the achievement of an ideal socialistic society will remain merely a pious hope.

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